1958 March 1958

THE CANADIAN CHARTERED ACCOUNTANT

The Audit of Brokers' Accounts

Capital Financing for a Growth Program

Training and Preparation for C.A. Examinations

The Accounting Profession Abroad

Recommendations on the Income Tax Act

Taxation of U.S. Citizens Resident in Canada

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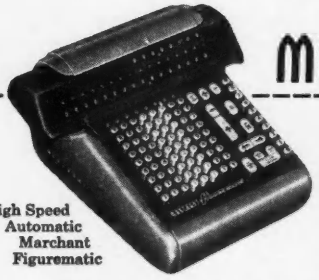

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THE CANADIAN CHARTERED ACCOUNTANT

VOL. 72, No. 3 MARCH 1958

The Canadian Chartered Accountant, March 1958. Published monthly by the Canadian Institute of Chartered Accountants. Chairman, Editorial Board, C. K. MacGillivray, F.C.A.; Editor, Renny Englebert; Asst. Editor, Jean Vale. Advertising Representative, E. L. Vetter, Editorial and business office: 69 Bloor street east, Toronto 5. Subscription rates: $6 a year; 60 cents a copy. Printed by General Printers Limited and mailed at Oshawa, Ontario. Authorized as second class mail by the Post Office Department, Ottawa. Opinions expressed are not necessarily endorsed by the Canadian Institute.

TREVOR F. MOORE (page 201)

"The key to capital financing for continued expansion is planning for capital needs two to five years ahead. In successful financing, integrity, imagination and flexibility are the key words. If there is one absolute principle in financing, it is the paramount necessity of creating and maintaining investor confidence." The preceding quote is from the lead article by Trevor F. Moore, "Capital Financing for a Growth Program", in which the author points the way to some of the basic indicators of success in this complex field. Raising capital is one of the most important undertakings of any company and the various methods of financing, with their advantages and disadvantages, are outlined in this discussion in the light of a constantly changing economy.

Mr. Moore has the advantage of looking at this subject after many years of experience in and knowledge of financial operations and corporate financing. He has been a vice-president of Imperial Oil Limited for the past five years and, before joining the company in 1950, was associated for 22 years with the investment firm of McLeod, Young, Weir & Co. Ltd., moving from sales and sales promotion to sales manager and, in 1946, becoming a director and vice-president of the company. He has taken part in many community activities and, during World War II, held executive positions in connection with Victory Loan drives. He is a past president of the Community Chest of Toronto, the Toronto Better Business Bureau and the Canadian Club of Toronto. He is also a director of the Boys Clubs of Canada and a governor of the Toronto Western Hospital.

J. B. HOWSON, C.A. (page 207)

The responsibility of accountants who handle the audit of brokers and dealers in securities and commodities is a very special one. This highly specialized type of examination involves a number of unusual features and in "The Audit of Stockbrokers' Accounts", J. Beverley Howson deals with the preparation for the audit and the procedures to be followed on the audit date. This is one in a series of articles on the investment business in Canada which will be republished later in the year in a brochure.

Mr. Howson is a partner in the firm of Thorne, Mulholland, Howson & McPherson and received his certificate in chartered accountancy in 1950. He is a member of the Institute of Chartered Accountants of Ontario.

L. J. SMITH, F.C.A. (page 219)

What is the tax position of United States citizens who choose to retain their citizenship while they reside in Canada? Although the number of American residents who have become Canadian citizens is in excess of 300,000, there are more than 120,000 American citizens now living in Canada who have retained their citizenship. For them, both Canadian and American tax laws are involved and in "Taxation of United States Citizens Resident in Canada", Lancelot J. Smith deals with some of the ways by which their U.S. and Canadian taxes may be minimized. The author has written an article dealing with a subject which every chartered accountant practising in Canada should certainly know about.

Continued on page 190

Growing pains?

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Mr. Smith is a partner in the firm of Gunn, Roberts & Company, Toronto, a Fellow of the Institute of Chartered Accountants of Ontario and a Governor of the Canadian Tax Foundation. He is also a member of the Taxation Committee and the Magazine & Publications Committee of the Canadian Institute of Chartered Accountants. From 1943 to 1956 he was the author of "How to Prepare Your Income Tax" which was published annually.

H. C. DIXON, F.C.A. (page 225)

While honesty, fairness and independence are accepted throughout the world as pillars of the profession's work, the thinking of accountants varies on matters of detail connected with these principles. For example, there is unanimity on the importance of independence, but the way in which this objective is achieved differs in various countries according to their regulations. In "An International View of the Accounting Profession", Harold C. Dixon comments on the opinions expressed on this subject by six practitioners from different countries who prepared papers for the Seventh International Congress of Accountants held last September in Amsterdam.

Mr. Dixon is a partner in the Hamilton, Ontario, offices of Clarkson, Gordon & Co. He obtained his certificate in chartered accountancy in 1936 and was admitted a Fellow of the Institute of Chartered Accountants of Ontario in 1956. Since 1948, he has been a special lecturer in Accounting at McMaster University. He is also chairman of the Executive Committee and deputy chairman of the Board of Trustees, McMaster Divinity College. He assisted in the

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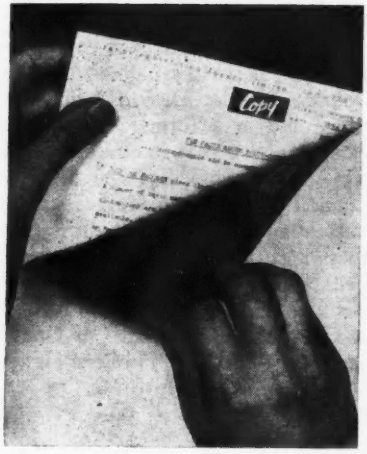

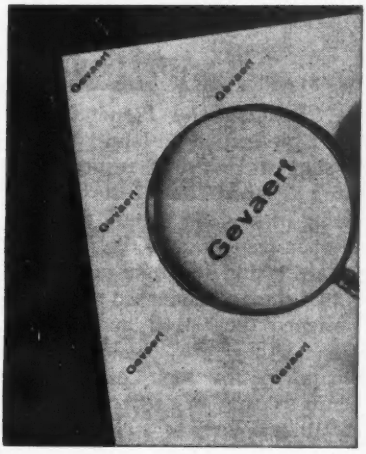

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formation of the Chartered Accountants Association of Hamilton and District which has now more than 200 members, and he served as secretary-treasurer and chairman of the Executive Committee.

J. W. BENNETT, C.A. (page 214)

In "Training and Preparation for C.A. Examinations", John W. Bennett suggests that those responsible in chartered accountant firms for the training of students should ask themselves at frequent intervals whether they are taking adequate measures to see that their students are getting the experience they need and how effectively they are assisting in the preparation for their examinations. Failure to carry out such obligations, the author points out, means that they are not fulfilling their responsibilities to the profession. The demand for highly qualified accountants increases with the growing complexity of our business society, and John Bennett's study of what can be done to assist students will be of considerable interest to readers.

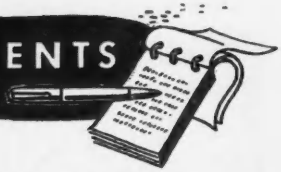
The author speaks from experience both as a partner, since 1956, in Deloitte, Plender, Haskins & Sells, Toronto, and as a former student who took an active part in student affairs. He was a member of the Students' Council of the Institute of Chartered Accountants of Ontario for three years and president of the council in 1949. He is at the present time a member of Council of the Institute of Chartered Accountants of Ontario and serves on the Public Relations Committee of that Institute.

EDITORIAL (page 199)

One of the most difficult problems in connection with setting up a professional practice is deciding on the right moment to do so. This month's editorial, contributed by K. Douglas MacLennan, not only challenges our members to consider their personal qualifications for establishing a practice but questions whether golden opportunities are being missed in starting on their own in this period of Canada's national development.

Mr. MacLennan obtained his certificate in chartered accountancy in 1944 and, after working with national firms of public accountants in the United States, he established his own practice in Windsor, Ontario in 1951. Since writing this editorial, he has merged with Clarkson, Gordon & Co., becoming a partner of that firm. He is a member of the Michigan Association of C.P.A.'s and served on their Committee on Professional Education and the Committee on Auditing Procedures.

NOTES AND COMMENTS



Appeals to the Courts in 1957

The taxpayer took 195 appeals to the Income Tax Appeal Board in 1957, according to a tabulation made by CCH Canadian Limited, and won 69 of them, at least in part. Of the 21 appeals he took to the Exchequer Court, the decision was in his favour in 8. The Minister in his appeals to the Exchequer Court was victorious in 7 out of 10. The Supreme Court of Canada, in a rehearing by the full court of an appeal by the Minister, found in his favour. The taxpayer referred two appeals to the Supreme Court, but lost both of them.

Information Bulletin No. 11

"Expense Allowances for Construction Workers" is the title of Information Bulletin No. 11 issued on January 30 by the Taxation Division of the Department of National Revenue. Superseding Information Bulletin No. 10, it permits a construction worker, required by his duties to be away from his ordinary place of residence for not less than 36 hours, to be paid a reasonable allowance in respect of his board, lodging and transportation which need not be taken into account in computing his income for the year.

The Gordon Report — Services

A study of Canada's service industries, prepared by experts at the Bank of Montreal under the auspices of the Royal Commission on Canada's Economic Prospects, is now available from the Queen's Printer at $2.00 a copy. It is a compendium of submissions made to the commissioners, as well as comments and suggestions from the commissioners and other interested persons. Included in the service industries are trade, finance, commercial and personal services, transportation and public utilities.

Electronic Computer for U. of T.

A new "electronic brain" is being installed in the University of Toronto's computation centre. An IBM Type 650 magnetic drum data processing machine, it will have several magnetic tape units which read or write at the rate of 15,000 characters a second. It performs at the rate of 78,000 additions and subtractions a minute.

Tax Agreements Signed

Canada has reached an agreement with Germany for the avoidance of double taxation with respect to income tax. She also has made agreements with the Union of South Africa for the avoidance of double taxation with respect to both income tax and death duties. Acts enforcing these agreements were proclaimed on January 1, 1958.

Income Tax Brief

The Taxation Committee of the Canadian Institute of Chartered Accountants and the Taxation Section of the Canadian Bar Association have prepared a joint brief on the Income Tax Act for submission to the Ministers of Finance and National Rev-

Continued on page 196

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Continued from page 194

enue. The text of the brief appears on pages 230 to 249 of this issue.

Executive Development Course

A four-week summer school in "executive development" for men in the middle-management group will be offered by McGill University School of Commerce from May 26 to June 20, 1958. Courses will be given in finance, marketing management, business policy and human relations by means of lectures, supplemented by case studies, seminars and conferences. Since the total registration will be limited to about 30, those interested should apply as soon as possible for application forms and any additional information to Professor Eric W. Kierans, Director of the School of Commerce, McGill University, Montreal.

Trade with Japan

Final figures for 1957 show that Canada's exports to Japan have risen to a record high of $140 million. Her purchases from Japan in 1957 remained at about the $60 million dollar level reached in 1956.

Liability and Inventory Forms

The certificate forms for the confirmation of inventories and liabilities made available by the C.I.C.A. office in December have proved very popular with the profession. The initial supply was exhausted in three weeks, and the stock has now been increased to meet the demand. Either the inventories form or the liabilities form may be obtained at a price of $1.00 for 50 or $2.00 for 100. Each is available in English and French. Orders should be sent to The Canadian Institute of Chartered Accountants, 69 Bloor Street East, Toronto 5.

Oil and Gas Tax Conference

A second annual conference on oil and gas taxation and estate and gift tax planning is being planned for May 14 to 16 by McMurry College, Abilene, Texas. Russell C. Harrington, Commissioner of Internal Revenue, will be the guest speaker at the conference's banquet, and nationally known experts will lead the discussions. For further information write A. R. Cecil, Dean, School of Business Administration, McMurry College, Abilene, Texas.

Organ of English Institute

With the appearance of its January issue, *Accountancy* became the official organ of the Institute of Chartered Accountants in England and Wales. For nearly 70 years this journal was published by the Society of Incorporated Accountants and Auditors which has now been integrated with the Institute.

Secretaries Institute

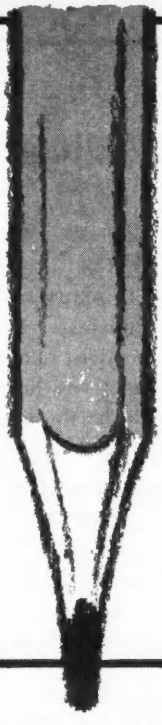
Letters patent have been issued incorporating the Chartered Institute of Secretaries in Canada. This action may be followed in some provinces by application for incorporation on a provincial basis.

In the News

LEON PAPE and DONALD GURARIE, both members of the Ontario Institute, have been designated chairmen of the accountants group for the 1958 United Jewish Appeal of Toronto.

Your Red Cross

A generous donation to the Canadian Red Cross means help for anyone in need, and you may be helping yourself.



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Editorial

ON STARTING A PRACTICE

MANY OF OUR members have within them that "divine discontent" challenging them to establish their own professional practices. While the possibilities intrigue them, some justify delaying a start because they require more capital and because of the varied experience that they are obtaining. Others who have left public work are afraid that, having been away from practice for some years, they may not have the ability and experience necessary to be successful in their own practice. And so they too continue along, reappraising the opportunities in public accounting and comparing them with their own circumstances.

Personal characteristics required by a student entering chartered accountancy include a good mind, integrity, stability of character and temperament, a determination to improve, and a desire to recognize opportunities and achieve his greatest possible degree of success. Some of these characteristics are particularly important to the chartered accountant considering establishing his own practice.

He must have pride in his performance, the type of pride that caused the ancient Greeks to finish their marble building blocks on the unseen inside surfaces to a high degree of perfection. The reputation of an auditor developing a practice is judged eventually according to his underlying work which only comes under scrutiny when inquiries are made by the taxation authorities, interested bankers, or inquisitive clients. The young accountant will usually have to prove himself to the public over a period of time before he will get engagements of any great responsibility. Meanwhile, while he is doing mostly bookkeeping work, this pride in his performance must be sufficiently strong to prevent him from losing sight of his original aims and ideals.

He must express himself well orally and in writing. Basically he is selling intangibles – knowledge and ideas. He must have the power of imparting these intangibles to the public, and the tact, diplomacy and understanding of human nature necessary to bring his clients to his way of thinking. He must be self-reliant, self-disciplined, and have the determination to struggle through many discouragements.

Insufficient experience is the chief cause of failure of new accounting practices. The problems of small business are usually as complex as those of a large business. Considering that the small business lacks a staff of specialists, the auditor serving small business must have an extremely wide background.

These qualifications appear formidable, and anyone contemplating establishing a professional practice must appraise his deficiencies. On the other hand, as William James stated, we usually function at only 20% of our capacity. Under the challenge and inspiration of our profession we are all surprised at our accomplishments when circumstances demand the exceptional.

The work force in Canada was 5,700,000 in 1956 and the Gordon Report tells us that it will be 9,637,000 by 1980. The national income was $18,808,000,000 in 1954 and it may amount to $75,000,000,000 by 1980. This tremendous rate of growth should raise the question in all our minds – are we employing our efforts in the most effective directions? It should raise the further question to anyone aspiring to become a practitioner – am I missing my golden opportunity by delaying?

There has never been a time in the history of Canada when there has been greater opportunity for men embarking on their professional careers in public practice than there is today. Are we blindly accepting the growth of Canada and our profession as a normal pattern and failing to realize the resulting opportunities?

NEW EDITOR FOR THE TAX REVIEW

With the current issue, A. Willard Hamilton relinquishes his position as Editor of the "Tax Review". He has written for the department entirely alone for the past year and has added much to the prestige of the chartered accountant in tax practice. The Editors of *The Canadian Chartered Accountant* are deeply grateful to Mr. Hamilton for the part he has played in making this department such an important feature of the magazine.

Beginning next month, the "Tax Review" will be edited by Campbell W. Leach, a partner in the Montreal office of McDonald, Currie & Co. Mr. Leach has been a member of the Institute of Chartered Accountants of Quebec since 1931 and for the past 20 years has made a study of tax matters. His activities have included serving as a member of the C.I.C.A. Taxation Committee when the present Income Tax Act was rewritten to supersede the old Income War Tax Act and three years as Governor of the Canadian Tax Foundation. For the past five years, he has been chairman of his firm's Taxation Committee and is currently a vice-chairman of the Canadian Tax Foundation. Mr. Leach has contributed articles to *The Canadian Chartered Accountant* and we are fortunate in having persuaded him to take over the editorial duties of this department.

Capital Financing for a Growth Program

TREVOR F. MOORE

IN ANY ENTERPRISE the planning for capital requirements begins many years ahead of the actual need. Essentially it is based on management's estimate of the company's rate of growth in terms of market demand, national growth and competition. In other words, management has to answer the question: "Where are we going?" and "How should we get there?".

Good capital planning should relate the company's growth program to the pace of the industry and the direction of the nation's economy generally. The degree to which a company succeeds under these changing conditions depends on how accurate are its forecasters in divining the ends, and how effectively management devises the means.

In our economy, with its multitude of companies in a variety of industries, it is not possible to set down any hard and fast rules on capital financing. This paper hopes to point the way to some of the basic indicators of success in this complex field.

Planning for growth is based on what experience has taught and what forecasting predicts. The limits of a planning period often are arrived at with an eye to the length of time that must ensue before a major capital project or development program materializes from a concept to an actual operation, a three-to-five year period being characteristic of many large enterprises.

Chiefly from its operating departments, a company coordinates all the information and advice it can muster regarding estimates of sales, supply conditions, and the position of the industry in relation to domestic, and perhaps world, markets. This is referred to as the operating program. It is compiled at least once each year and revised as many times as necessary. From it stem the estimates of departmental and corporate profits, capital expenditures, cash position, etc.

Motives for Expansion

When an operating program has been projected, and the forecasters have given their best estimates of likely trends, the company's management may conclude that all available information indicates the need for expanded capacity. There may be many motives for arriving at such a decision. Management might see the need for expansion to (1) maintain

the company's competitive position in a growing industry, (2) ensure greater stability of earnings by extending or acquiring some major phase of the industrial process, (3) reduce risks by expanding into more diversified activities, (4) attain economies of administration and more certainty in supplies, transportation and distribution. These are common examples, and there may be other motives for expansion.

Once the decision has been made to expand, the two primary questions asked by management are: first, what can we do to finance such a program internally, without borrowing? Secondly, if we decide to go to the market for our funds, what type of offering would yield the best results for the company?

Trends in Financing

Canadian business has financed the larger part of its capital programs internally, by use of shareholder funds, retained earnings, depreciation and the sale of assets. In the years 1945 to 1954, undistributed corporation profits and depreciation allowances financed 52% of total new private investment in Canada. In recent years there are instances of growth companies internally providing over 80% of their financial needs. In periods of extremely active growth, however, it becomes increasingly difficult to keep pace with expansion solely by internal financing and, as recent experience has shown, the sale of securities to the public is likely to become necessary.

Cash Forecasting

To answer the question of how much financing, a company usually will start with that basic component of the planning period – the cash forecast. The problem of capital needs will be approached by forecasting what the cash position will be at the end of the current year, and, assuming a typical five-year planning period, at the end of each of the four subsequent years.

The management of a corporation's cash flow is an important factor both in short term and long term forecasting. On a long term basis it is an attempt to maintain an adequate flow of funds to meet the projected needs of the company. The same purpose holds for the short term, plus ensuring that such funds are fully employed. The cash position, by revealing the adequacy of working funds, serves as the indicator to warn management when the point may be reached at which additional funds may be required.

Cash forecasting procedures vary greatly among different firms and industries, but essentially they are based on painstaking estimates of the sales outlook. When the final sales estimates are interpreted and correlated, they are translated into dollar revenues and net profits for departments and with suitable adjustments for the corporation.

Throughout the cash forecast period, it usually is assumed that changes in prices cannot be predicted. Obviously, variations in actual figures compared with estimates resulting from a change in prices or operating costs will be recorded as they occur. The forecast is altered accordingly, and the whole position is reviewed in terms of the latest estimates of sales and profits available for the current year. Revisions are made in the estimates of the next four years to take into account a change in margins or some substantial change in the es-

timates. In character, the forecasting process really is a continuing program of perpetual change and adjustment.

The cash forecast provides a company with estimates on which its departments can base their current and capital programs. Its purpose is to provide a knowledgeable estimate of sales, costs, depreciation and profits, and, assuming taxes remain the same, net profits after taxes.

From these figures we can compare retained cash earnings, i.e. after dividends, net profit plus depreciation, with the estimate of capital expenses. The amount by which the latter exceeds retained cash earnings is the amount by which cash will be depleted. Now managment has reached the point where they can take a look at the cash and equivalent position, such as short-date government securities and other paper, and ascertain how long before it will be reduced to a minimum amount required for the company's day-to-day business.

In this entire procedure of cash forecasting, we have endeavoured to accumulate sufficient information to trace the financial position of the company at the end of the current and each of the next four years, with emphasis upon the cash position. Other needs and more sudden requirements for cash are outlined further on.

Let us assume that the estimated cash position goes below the normal everyday requirements of the business by the end of 1958. If this estimate is accurate, and the company will know more about it when the up-to-date forecast is available, the time of financing can be narrowed to a period of, say roughly, the fall of 1958 or the spring of 1959. At the present time [the autumn of 1957] the treasurer and comptroller, who are immediately responsible for the finances of a company, will be discussing informally what their recommendation will be in the light of today's conditions.

It is at this stage that the question of providing additional funds is thoroughly examined, and we return to our first question: should this be done internally?

The first step that would likely be considered on this question is what could be done through a renewed effort to increase sales and reduce costs. Increased emphasis would be placed on minimizing accounts receivable and inventories. Other alternatives, such as the sale of assets, would also be considered.

Basic Factors

If the decision is to obtain funds by new financing, the following questions would be carefully studied: (1) the amount of funds required, taking into account the needs over, say, a three-year period or perhaps for a much longer period, (2) what corporate restrictions may exist with regard to changes in the capital structure, (3) the condition of the money market at the time of issue, and (4) what type of issue would ensure the lowest cost, protect the shareholders and have the least impairment on future borrowing power and methods of financing.

Types of Issue

In a well established company, the corporation's officers would likely weigh the attributes of a debenture issue, with few if any restrictions, against the desirability of issuing common shares. Alternatively, they might consider a combination of the

two, in the form of debentures convertible into common at attractive prices in relation to the current market or with valuable rights attached, either of which would tend to reduce the coupon rate for a company with A-1 credit. Such a step can involve dilution of the equity unless existing common shareholders are prepared to buy sufficient of the debentures to maintain their proportionate interest in the equity. This type of financing is a means of raising equity capital in that, if the rights to convert or purchase have been shrewdly priced, it will be a matter of a few years only before the outstanding debentures are replaced with common stock.

The key to capital financing for continued expansion is planning for the capital needs two to five years hence. For a rapidly-growing, healthy business, it is probably an advantage, in terms of investors' confidence, to give the public an opportunity to share in its expansion through the issuance of securities. Whether or not this should be done by infrequent large issues or by coming to the financial market every two or three years is another decision which management may be in a position to make.

Credit Rating

The guide to such decisions is the basic premise that the company's credit position should be unimpaired. Credit may be determined statistically by many things: times-interest coverage, the ratio of debt to shareholder investment and so on.

When the financial officers have reached the stage where a recommendation on the type of financing is ready, it is common practice to consult outside advisers, the investment houses. Such consultations relate entirely to ways and means, and costs. The Board of Directors makes the final decision on these recommendations, and the company is ready now to enter into an agreement for underwriting and to prepare a draft prospectus.

Problems of a Bond Issue

Let us assume the decision is made to issue bonds.

A company with top credit rating would not likely be required to have its debentures secured by mortgage against company property. More than likely, the only restriction would be to the effect that the company would covenant not to issue a security which would have a claim prior to this debenture issue. Having in mind existing debt and the possibility of further debt financing, sinking fund and redemption provisions are carefully debated, as is also the term of years to maturity. Finally, of course, are the matters of price and the underwriting fee or commission. These may have been patterned by previous negotiations, in which case they will not be too difficult to settle.

In the matter of price, the company is torn between a natural desire to obtain the best possible price and a hope that the buyers will not only be attracted by but will be happy with the immediate and future market quotation for the issue. Even when the company has a firm underwriting and is assured of its funds, barring a political or financial catastrophe, it is not pleasant to see the offering drag over a period of many weeks, indicating that the decision with respect to price erred on the high side.

Pricing of an issue, which includes coupon, term of years and actual price, requires expert handling. It is

a matter for discussion and judgment among the financial officers of the company and those experts in the investment field who, as marketers of securities, should know the answer.

A similar period of discussion precedes an offering of common shares, particularly if the offering is to the market without preference to shareholders. In this instance pricing may be more difficult. If the company has decided that to avoid dilution of shareholders' interest, equity capital will be raised by the offering of rights, the investment houses may agree to underwrite that portion of the shares not taken up by shareholders.

Other Conditions of Financing

Despite all forecasting, however, a company may face a relatively sudden need for funds because of an unexpected opportunity to acquire valuable assets. If it goes to the market, a company would evaluate the same basic factors, but in terms of the immediate need for funds and their purpose. For purposes of such financing, bonds would have the advantage of stated maturity dates, and the interest costs would be tax deductible. A preferred stock issue does not require a pledge of assets; it could be subject to retirement and, without convertible or participating provisions, it would not likely injure the interests of the common shareholders. As preferred stock is retired, the position of the common stock tends to be improved. But a preferred stock dividend is usually high, to attract the investor, and is not deductible from corporate profits before computing taxes.

The company must balance the need to attract funds quickly, with the necessity of maintaining a good capital structure and credit rating.

New Companies

To this point we have considered only the well-established company. Comparatively new companies, requiring capital from the public markets, must establish their credit. This will be easier if a well known and reputable investment house promotes the financing. Assuming a good basis of equity capital, such companies must offer their bonds or debentures at rates which are more attractive than normal, or with equity capital attached in one form or another.

In recent years we have seen many instances where newly established companies with good growth possibilities have financed through the issue of notes or debentures which are little more than a promise to pay. Such issues may be convertible or have warrants to buy common shares attached, or they may carry with the original offering some common shares, the price of which is included in the "package". Such "package" offerings, however, also may be symptomatic of tight money conditions in the market generally.

Regardless of its status, a company going to the market will measure carefully the attributes of debt and equity in terms of the purpose for the new funds, its capital structure, credit rating, and the cost. It will survey the condition of the market, and make comparisons of costs between interest obligations and dividends per common share. Astute timing is of the essence.

Whatever decision is made, it will be based on considerable study and thought with a view to supplying the company's financial requirements for

a given period of years, and providing that all-important balance between debt and equity. Events of the past few years have shown that there are an infinite number of variations in patterns of capital financing. As indicated, there may be times when such patterns of financing are dictated merely by the need for more funds.

In successful financing, integrity, imagination and flexibility are the key words. If there is one absolute principle in financing, it is the paramount necessity of creating and maintaining investor confidence.

Aside from statistical measures of credit rating, and estimates of the company's growth potential, investors' confidence is based on many intangible factors which reflect the company's standing in the community. The frank disclosure of pertinent information in the annual financial statement, the business and community activities of the company's executives, and its treatment of employees, and general responsibilities, are all attributes which, over the years, go into the building of a corporate character.

Without that vital element of public trust and community approval, no business can long survive. It is the single most important factor to be kept in mind as you approach the financing period and plan for the future.

PERSONNEL FUNCTION OF MANAGEMENT

In the task of management the human factor has emerged as one of critical importance. The employment of human resources to the best possible advantage of the enterprise presents a major challenge to management. This fact has led to the recognition of personnel management as a distinct function which must play its full part in the formulation of managerial policy and in the direction of day to day affairs of the enterprise. To achieve these ends the personnel function is concerned with the identification, evaluation, coordination and control of the human factors involved in the management of an enterprise. Essentially it has the responsibility for ensuring that the intangible factors and imponderables associated with human behaviour are given the emphasis they deserve in the councils of management. The full significance of these factors to the successful operation of the enterprise is not always apparent at first sight. It is the task of the personnel function to ensure that they are taken fully into account in conjunction with the more obvious and easily measurable material factors such as plant, materials and finance. To be effective, the personnel function requires a proper allocation of managerial resources of knowledge, skill and character.

— "Personnel Function of Management" by M. Forman, a paper delivered to the Conference on Human Relations in Industry, Rome 1957.

The Audit of Stockbrokers' Accounts

J. BEVERLEY HOWSON

ONE DEFINITION of a broker, given by the Oxford dictionary, is "middleman between buyer and seller, agent". The stockbroker not only fulfils this function these days, but also may act in the underwriting, promotion and distribution of securities, be custodian of clients' securities, and provide information on investments and other services. Since he deals almost entirely in other people's property which is of a very valuable and portable nature, his responsibilities are even greater than most other kinds of brokers. Because of this, he is regulated by a very extensive system of control and audit in addition to that portion of common law pertaining to brokers generally.

The largest number of stockbrokers and securities dealers in Canada are in Ontario and Quebec. The Securities Act of these provinces puts the general regulation of the Investment Dealers Association, the Broker-Dealers Association and the Stock Exchanges in the hands of their respective governing bodies. The Securities Act of Ontario, for example, requires the following:

> 33. Every Stock Exchange, the Central District of the Investment Dealers' Association of Canada and the Broker-Dealers Association of Ontario shall,
>
> (a) select a panel of auditors each of whom shall have practised as such in Ontario for not less than five years and shall be known as a panel auditor or members' auditor; and
>
> (b) employ an exchange auditor, district association auditor or association auditor, as the case may be, whose appointment shall be subject to the approval of the commission and the appointee shall be an auditor who has practised as such in Ontario for not less than ten years. (*R.S.O. 1950, C. 351, S. 33.*)

Each association member must select his auditor from the panel mentioned in (a) above, who makes the audit of that member required by the rules of his particular association and reports thereon to the association auditor, mentioned in (b) above.

The Act also requires that these regulations concerning audits and the audits themselves be satisfactory to the commission mentioned, which is the Ontario Securities Commission.

Brokers and investment dealers who are not members of the associations mentioned above come under the direct control of the commission and are required to keep proper records, and file annually and otherwise as required certified financial statements reported on by their auditor.

The exchange or association auditors issue instructions to the members' auditors which set out the minimum audit requirements, and the forms and reports to be made. It is up to the panel auditor to decide whether these minimum requirements are sufficient in any particular case. The requirements of the various exchange or association auditors vary somewhat in detail but all can be said to be designed for the same purpose, that is, to ensure that the member is solvent and that he is adhering to the rules of his association or exchange.

Preparations for Audit

There are two types of regular audits, the annual audit which is on a fixed date and the surprise audit which, as the name implies, is called at some date chosen by the governing body. (For members of the Toronto Stock Exchange this takes the form of a questionnaire which is prepared by the member firm or by the panel auditor at the request of the member firm).

Preparations will of course vary for each type of audit. In the case of the surprise audit, since no advance notice is given to the member firm, preparation is pretty well limited to arranging for sufficient staff and working materials.

For the annual audit, the broker's staff should be instructed to prepare requests for confirmation of bank balances, call loans including securities held as collateral, accounts with other brokers, clients', partners' and firm's accounts, and any other items which might be peculiar to the particular firm to be audited. They will also prepare, as soon as possible after the audit date, trial balances of all ledgers which will include extending security values and margining where necessary, prepare transcript of the securities position books and generally do as much of the detail of preparation as possible. All work done by the client's staff will be checked by the auditors.

Audit Procedure

SECURITIES AND CASH COUNT

On the audit date, the securities and cash must be counted, and in most cases this can be done at the close of business without disturbing the regular routine of the cage. The auditor should take immediate control of all the firm's cash and securities until his count is completed. If there are branch offices, provision must be made to verify their securities, cash balances and accounts in the same manner and at the same time as for head office. Securities should be kept under seal until released. Arrangements should be made for the custodians of the broker's safety deposit vault to deny access to any one not accompanied by designated members of the audit staff until notified by the auditor. The custodians must certify that these instructions were carried out, to ensure that if it is necessary to enter the vault before release of the securities a member of the audit staff would be present to record the movement of the securities.

The securities held are classified as to three types:

1. Those in the "General box" which are firm's securities, those held for clients' margin accounts, or those out for transfer (which latter are evidenced by transfer receipts of the various transfer agents).
2. "Safekeeping" securities are securities specifically held as a service for the customer.
3. Securities held "Free" are securi-

ties held for a customer whose account has a nil or a free credit balance.

The broker is required to hold these latter two types separate from his general box.

In the larger brokers' offices the sheer volume of securities will sometimes make it impossible for the count to be finished before allowing access to the securities by the cage staff, and then the auditor must list and so control all securities received or delivered. Since those securities held in safekeeping or free for clients are often not required immediately, it is usual to leave them to the last or sometimes, in non-surprise audits, to take control and count them before the close of business. In this last case, care must be taken to keep track of any transfers between categories which might have to be made during this count and to retain control until all securities are counted.

Securities in transfer are listed from the transfer receipts and this listing compared with the returned certificates. It is good practice for a member of the audit staff to accompany the broker's messenger when these are picked up. One of the audit staff should also be instructed to record the details of all incoming registered mail as it is received. All items not returned in the next few days, out of town transfers and stocks transferable only on the books of the particular company should be confirmed in writing. If any certificates counted are registered in a private name, they should be noted and checked to see that the name is that of a client for whose account the stock is held, and that they are not included in margin calculations. All securities affecting margin accounts must be immediately negotiable and any endorsements other than the firm's should be guaranteed.

Checking the Stock Position

When the count is finished, but if possible before the securities have been released, the count should be checked to the stock position book. This is a ledger with a page or account for each security held, giving on the "long" side the ownership of the security, e.g. due to clients, partners or firm, other brokers, etc., and on the "short" side the location or sources from which the securities will be obtained, e.g. held in boxes or out for transfer, held by bankers as collateral for call loans, due from clients, firm or partners or other brokers, etc. This record can be expected to balance in itself in an adequately run office and if the count should disagree with the figure as shown therein, the particular security should be recounted at once. If there should still be a difference, the other items on the stock position should be checked in order to find the error as soon as possible.

It would be ideal to be able to check the other items in the stock position right away in every case, but except in very small offices this is just not possible. However, the count at least should be agreed before control of the boxes is relinquished. To have to recount at a later date and then reconcile back to audit date can be a very difficult and time-consuming job.

Mailing Statements

As soon as the statements of the customers' and other brokers' accounts are ready they can be checked to the trial balances and ledgers and then mailed. The Toronto Stock Ex-

change's annual audit instructions in this regard may be taken as representative. They are as follows:

"Joint accounts with others" — Statements of the position of joint accounts showing each party's interest and the debit or credit balances and security positions in connection therewith are to be mailed to the other parties interested with a request for verification both as to the dollar amount and securities.

"Clients' balances" — Statements of the clients' accounts as at March 31, showing the amount owing to or by the broker and securities pledged (including securities held free and for safekeeping) are to be prepared by the broker's staff and checked with the trial balance by the auditor. The auditor must see that all statements are stamped with his own stamp and bear the following or similar wording:

FOR AUDIT PURPOSE

If there is any error in the particulars shown by this statement, will you kindly send it, together with full particulars of the differences, direct to our auditors (name and address of auditor).

The auditor must mail these statements in his own envelopes, and satisfy himself that statements have been sent to all clients having balances on the broker's books or for whom the broker is holding securities free or for safekeeping. Any difference reported to the auditor must either be cleared up to his satisfaction or reported to the Exchange auditor.

"Partners' trading accounts" — By certificate.

"Brokers' accounts" — By sending out statements or letters to the broker showing the position of the account, the securities borrowed, the securities loaned, when issued contracts, open commodity contracts and by obtaining a certificate from the broker that the position of the account and securities is correct. (It should be noted that the Toronto Stock Exchange Clearing House has now undertaken to verify direct to the respective auditors at the regular audit all items cleared through it.)

When these instructions have been carried out, it will be possible to carry on with the balancing of the securities positions. The first step is to be sure that the position of each individual stock balances in itself, that is that the number of shares on the long side, (for whom it is held or to whom it is owed), agrees with the number of shares on the short side, (where it is held or by whom it is owed). The next step is to check that the number of shares shown on the stock position agrees with the amounts counted or confirmed and with the holdings as shown by the various ledgers such as the clients' ledgers. This is done by cross-checking from the clients' trial balances, the securities counts and confirmations (such as for stocks held in the call loans) to the stock positions, at the same time checking in the clients' and other accounts the market values of securities entered there. These values and the prices from which they were calculated should have been checked. The prices used are obtained from the official Exchange sheets or in the case of unlisted items from other published quotations or, failing this, from a reputable broker.

Reviewing Marginal Accounts

After the security values have been

checked for each client's holdings, the margin calculations should be reviewed. The margin requirements vary as between the several authorities, and of course the calculations will have been made according to the rules of the particular association to which the firm belongs. The total margin values are compared with the balances of the accounts and the accounts then broken down into their various categories which are:

1. Free balances which are credit balances owing to the client free from encumbrance.
2. Cash settlements, accounts cleared up within a specified time.
3. Fully-margined accounts whose margin value is adequate.
4. Under-margined accounts whose margin value is insufficient but whose security value is sufficient to cover.
5. Partly-secured accounts which are not only undermargined but whose security value is insufficient to cover.
6. Unsecured balances.

The following examples might help to clarify those terms which are not self-explanatory. They are based on a margin requirement of 50%.

Stock	*Market Value*	*Margin Value*	*Ledger Balance*
FULLY MARGINED DEBIT BALANCE			
10 Abitibi (long)	$300	$150	$300
10 Cons. Paper (long)	$350	$175	
	$650	$325 (greater than debit ledger balance)	
UNDERMARGINED DEBIT BALANCE			
10 Abitibi (long)	$300	$150	$300
— in this case, the margin required is $300 — $150 or $150.			
PARTLY SECURED DEBIT BALANCE			
10 Abitibi (long)	$300	$150	$350
— in this case, the account is not only undermargined, but is also undersecured by $350 — $300 or $50. In addition this account will be under-margined $200 similarly to the above.			
FULLY MARGINED CREDIT BALANCE (ON SHORT SALE)			
10 Abitibi (short)	$300	$450	$500
— in this case the client has sold short, that is sold shares with intent to repurchase at a lower price, rather than to deliver, so that one might say the sale puts him in a negative security position and he must put up cash or equivalent over the credit which arises on sale, to the extent of the margin requirement at least.			
PARTLY SECURED CREDIT BALANCE (ON SHORT SALE)			
10 Abitibi (short)	$300	$450	$275
— in this case the credit balance is less than the market value of the stock, and the account is partly secured by $300 — $275 or $25; as well as being undermargined in an amount of $175.			

If a client has more than one account or guarantees other accounts (which guarantees should be examined), these accounts are grouped for margining purposes. As far as other brokers' accounts are concerned, although requirements vary, it is usually only necessary to margin those accounts of non-member brokers which are not cleared within a specified time. Customers' accounts should be carefully checked as to whether stocks and securities of a customer, fully paid for and not subject to lien, are properly segregated and available on demand as required by the regulations of the associations and the Criminal Code.

If such is not the case, note should be taken as to how the matter was rectified. In addition, the auditor is in most cases required to check that no security carried on margin or used as collateral for a customer is used for making delivery on a sale or short sale without specific permission in writing.

Additional Operations

Most of the time spent on the audit of a broker of any size is taken up by the foregoing operations. In addition, the bank accounts must be reconciled and in this process particular attention should be paid to inter-branch transfers, if any, and if there are notes or drafts under discount, as to whether or not these are current or have been renewed. If any have been returned unpaid subsequent to audit date, the particular account must be margined in the usual way. The cash books should be reviewed for the periods prior to and after the audit in order to discover any unusual items which might affect the position of the broker.

Sundry accounts receivable and prepaid items should be confirmed and checked. They will consist largely of advances to employees and prepaid insurance premiums, etc. In this connection, the insurance coverage should be reviewed with an eye as to whether it is adequate and complies with regulations of the exchange.

Fixed asset items can be verified from invoices or in the case of stock exchange seats by confirmation from the exchanges. The provision for depreciation or amortization should be reviewed where applicable.

The review of the cash books mentioned above will be helpful in verifying accounts payable and accrued liabilities and a comparison with prior periods is a useful yardstick. Provision should be made for income tax liability on the earnings of the firm.

If the broker is incorporated, the capital stock records and minutes must be examined, as must the partnership agreement if there is a partnership. If part of the capital is represented by loans of any sort, most associations require that these be subrogated to the interests of the other creditors and such subrogation agreement should be inspected.

Preparation of Statements

When the audit has been completed, it remains to prepare the statements required. Perhaps the most important of these are the statement of assets and liabilities, which is self-explanatory; the capital and leaning position form, which shows to what extent the capital of the firm is carrying or is being "leaned on" by undermargined or unsecured accounts (or, in the extreme, whether the firm is "leaning on" the clients' surplus securities); the capital requirement form,

which shows the adequacy or inadequacy of the net free capital based on trading volume; the auditor's and members' certificates and, in the case of the Montreal and Canadian exchanges, a copy of the auditor's report to the broker on the system of internal control in force. Other exhibits are required, the requirements differing according to each exchange or association.

These forms are filed with the exchange or association auditor who reviews each set and, if circumstances warrant, may call for further information or audit after such review.

In the foregoing, an attempt has been made to set down the special features of a stockbroker's audit. In addition, it must be borne in mind that the regular audit procedures, tests, etc. will apply and must be carried out where deemed necessary. Such tests would include examination of banking transactions, billing procedures, system of stock certificate control, gross revenues, specific expense accounts and any other matters that come to the attention of the auditor during the course of his review.

It is significant in the audit of stockbrokers' accounts to realize that, in addition to controlling money balances, the auditor is examining, testing and verifying the securities to which the dollar figures relate.

A MATTER OF WILL

Communication can only be established effectively when the members of an organization are brought together in the course of their daily work whenever something needs doing, with a desire to do it in collaboration. There must be occasions when minds can be shared, and a willingness to do so. In technical language, nothing can be achieved unless the formal and informal organization of the firm are in harmony. Effective relations result in effective communication; they are in any event a prerequisite of it . . . . the mere provision of machinery for joint consultation is useless, and perhaps worse than useless, unless there are individuals available who are prepared to trust each other, who desire to meet together to discuss matters of mutual interest, and who possess the necessary social and psychological attributes to enable them to do so. The problem thus revealed is one of basic organization, and selection and training of staff rather than one of administrative techniques.

— "Problems of Communication in Modern Industry" by T. S. Limey, a paper delivered to the Conference on Human Relations in Industry, Rome 1957.

Training and Preparation for C. A. Examinations

JOHN W. BENNETT

THE CONTINUING shortage of college and high school graduates who are interested in chartered accountancy remains one of the problems of the profession. It is worth noting, however, that, in spite of this, some practising firms manage to obtain their full quota of students each year, while others always fall short.

This is no accident and does not come about because one firm pays a much higher salary or offers better working conditions than others. Graduates may consider these factors, but they also place emphasis on the education and experience that each firm is willing to give them. All other things being equal, they are going to choose the firm which has a detailed plan for their training.

In the matter of education, ten years ago chartered accountancy had substantial advantages to offer compared to industry, where a higher salary was the only attraction. In recent years, industrial firms have broadened their staff training program, which has produced many of their present executives. They have encouraged employees to take extra courses, at the company's expense, to improve their business background. All this is designed to further their staff training program.

This great improvement by industry has seriously reduced the educational lead that the accounting profession once enjoyed. Whereas the course of instruction has been periodically revised by the Institute of Chartered Accountants of Ontario, some chartered accountant firms have been slow to revamp their own staff training program and make full use of the revisions put into effect by the Institute. The profession has increased student salaries by a very considerable percentage over what they were ten years ago but has not increased the staff training program to anywhere near the same degree.

Every chartered accountant firm should examine what it offers a student not only in salary but in education. It should ask itself two questions, "How has our staff training program been improved in the last five years? Are all the partners of our firm fully cognizant of the fact that training students to become good chartered accountants is an important part of our firm's function?" If a firm cannot point out at least six improvements in staff training in the last five years, its program is inadequate and should be revised. If the partners of the firm do not believe that training students is part of their over-

all responsibility, they do not realize the proper function of a chartered accountant firm under the apprenticeship system.

Place of Induction Program

Staff training and preparation for examinations should start with the initial interview of any potential student-in-accounts. Because of the shortage of students, firms have been forced, in some cases, to accept unsuitable applicants who will never become good chartered accountants. A student-in-accounts should never be hired merely to fill a vacancy with the idea that if he is lucky he may become qualified. Hiring such a student is not only unfair to the person himself but is grossly unfair to the profession, because each chartered accountant's ability, or lack of it, reflects upon the entire profession.

A definite program for taking on students should be installed by all firms regardless of their size. This program should be so arranged that those who are unsuitable will be turned down and anyone who is hired will, in the firm's opinion, be a credit to the profession. Aptitude tests and preliminary indoctrination courses will assist a firm in deciding upon applicants. After a firm has hired a suitable applicant, it must then realize that it has taken on a great responsibility. The new student should not be looked upon merely as an employee but also as a person who is doing post-graduate study in accounting and auditing. The student expects, and should receive, not only an adequate salary but also a daily educational course during his apprenticeship period.

After a firm has estimated its student requirements, the partners in the firm should ask themselves the following questions:

1. What practical experience will these new students be receiving in the next 12 months?
2. What plans have we made to insure that adequate experience will be given to the new students?

It is not enough to send out a new student on an audit and tell him to report to Mr. J. Doe, C.A., the accountant in charge of that audit. There must be a definite plan for improving the student's practical experience. One obvious method is to see that he does not work on the same type of audit all the time. He must also be allocated to various phases of audit work, e.g. accounts receivable on one audit, banks on another, etc.

Students are Students

The partners in a firm of chartered accountants should consider themselves as a Board of Education, the supervisors as principals of high schools or colleges, and the in-charge accountants and senior students as the teachers or lecturers to their subordinates. This thinking must emanate from the senior partner in each firm down through the chain of command to the lowest junior. The in-charge accountant on an audit must be made to understand that the students who are working for him are to be treated as students, and their questions are not to be brushed aside with the age-old excuse that he is too busy to go into the problem at that time. A student's curiosity and ambition to learn must be encouraged and the in-charge accountant must develop it to the best of his ability, answering questions on theoretical or practical accounting and auditing problems.

Need for Meetings

Monthly or semi-monthly staff meetings to discuss questions that have been brought up by chartered accountants and students are a great help in encouraging them to ask questions and endeavour to solve problems themselves. Of course, the in-charge accountant can clear a great many minor points with the student in a matter of minutes. However, important problems which the in-charge accountant has discussed with a partner should be brought up at a meeting so that the students may learn the solutions to them. This will reduce the number of questions that an in-charge accountant or student will pose to a partner because he will then have a precedent to follow when he encounters the problem a second time. These meetings will also help the student to a better understanding of what he is trying to do when he is working on an audit. Many firms have such conferences at the present time, the larger firms finding them easier to conduct than the smaller ones. However, in a smaller firm a meeting every three months with the staff would tend to increase both experience and morale. Three or four small firms could work together to arrange a meeting. Smaller firms should try this suggestion before dismissing standard procedures of training as impractical for them.

In addition, special meetings of the entire staff should be called to discuss the bulletins issued by the Committee on Accounting and Auditing Research of the Canadian Institute of Chartered Accountants. These bulletins should be discussed in detail with the entire staff and the firm's opinion expressed by the partners to the members of the staff. The application of bulletin rulings to specific clients can also be reviewed. While the majority of junior students will not add much weight to this discussion, they will at least learn something, and it is not beyond the realm of possibility that some may offer very practical suggestions. Other special meetings should be called to study amendments to the various Income Tax Acts. The introduction of a new Tax Act, such as the Ontario Income Tax Act, requires a full scale staff discussion so that everyone – partners, supervisors and even lowly juniors – is fully aware of what has happened.

Systems of Staff Handling

Two main systems of handling staff are the pool system and the staff system. Under a pool system the entire audit staff, other than partners and supervisors, are grouped in a pool and allocated from this pool to all the audits of the firm. In a staff system a partner is responsible for various audits and is assigned certain employees to work for him. These employees do not work for any other partner or on any audits which do not come under their staff partner. A pool system is generally of much greater advantage to the students than a staff system, unless the latter can be conducted so that each staff has a variety of audits and each student is not with the same staff for his entire career in the firm. A pool system creates more organizational problems but gives the student greater experience in audit work. Its one big disadvantage is that a student may not be on one job long enough to learn anything from it, but the person in charge of allocating staff to audits should watch carefully to make sure that a student is not put on one large job for a few days

and then taken off and put on another for a short time. The staff system of handling employees can work out if it is done properly. The large firms who use the staff system should ask themselves the following questions:

1. In setting up a staff system of employees, have we considered the experience available to each employee?
2. In allocating new audits to various staffs do we consider the variety of audit that each staff has or do we tend to allocate all of one type of audit to one staff?
3. Do we attempt to inter-change staff members so that each employee will receive a variety of experience?

If a firm can answer "yes" to the above three questions, its staff system has all the advantages of a pool system not only for the firm but for the students themselves. However, if a firm cannot answer "yes" to these questions, it should consider either switching to the pool system or changing the method of allocation of employees and audits.

It is quite practicable for a firm of chartered accountants, large or small, to set up a system of staff evaluation. There are many methods of doing this and any system is suitable as long as each individual student's progress is being charted in some way, so that if he is falling down in some aspects of his work a partner can discuss the matter with him and point out his weaknesses.

In revising its correspondence course, the Institute of Chartered Accountants of Ontario has made many improvements. However, the big disadvantage in a correspondence course is that there are no lecturers or teachers available to students for informal discussion. To supplement this need, chartered accountant firms should ask themselves:

1. How are our students doing in their correspondence course and what type of marks are they receiving?
2. How have we assisted the students in understanding the lessons that they are preparing and sending on to Queen's University?
3. Have we given our students any assistance in preparing for a written examination?

If a firm is embarrassed by these three questions, it is doubtful if it is carrying out its obligations to its students and in turn its obligations to the profession.

Preparation for Examinations

Assisting a student to prepare for his examinations at the end of a year is a very simple matter. The Ontario Institute runs a series of lectures in the Institute's building in Toronto and reviews previous years' examination questions. These lectures can be supplemented by each firm following the pattern set by the Institute. A series of lectures should be given to the students before they write their primary, intermediate or final examinations and a review made of previous years' questions and answers. It should be carefully planned in advance so that the partners and supervisors can prepare material that will benefit the students. In a small firm which has only one candidate, it may be rather impractical to do this, but two or three small firms could group together for this review.

Assisting in Lessons

The problem of assisting students in their lessons is a little more complicated and requires more planning.

Each student might report on the bottom of his time sheet the lesson now due in his year, the lesson that he has most recently sent in, and also the marks that he has received on any lessons returned to him. The partner reviewing the time sheets can check up on students who are extremely late with lessons or are receiving poor marks. Possibly a student is late because of the burden of overtime work and this should be corrected as soon as possible. A partner or supervisor should be appointed to be "father confessor" to a certain number of students. Some firms require students to bring in lessons on which they received less than a "D" in order to go over the lesson with the student and endeavour to point out the errors that were made. During this review a great deal can be learned as to how well a student understands his lessons, and thus the student is assisted materially.

The training of students and preparation for examinations is so closely integrated that it is almost impossible to separate the two functions. Each chartered accountant who is employed by a professional accounting firm, whether as an in-charge accountant, supervisor or partner, should begin thinking in terms of teaching the student and not merely of using him to do small minor jobs that do not need much experience. There are a great many problems in training students under the apprenticeship system. Some firms have objected to setting up courses and giving extra lectures to students on the grounds that it would be too severe a drain on their time. Yet no other aspect of the profession is more important than the training of future chartered accountants. The student has placed his trust in the firm with which he is working to give him an education equivalent to that received in any other firm in his Institute. If even the smallest firm fails in its obligations, it is betraying not only that trust but also the trust that the profession has put in it by allowing it to employ students on the expressed understanding that it will give them the practical and technical education and experience to become good chartered accountants.

Blessed is the man who, having nothing to say, abstains from giving in words evidence of the fact.

— George Eliot

Taxation of United States Citizens Resident in Canada

LANCELOT J. SMITH

IT SCARCELY needs to be said that the practising chartered accountant should always be on the alert to provide assistance to senior executives of corporate clients who may have tax problems. Due to the close relationship of many Canadian companies to parent and affiliated companies located in the United States, it is not unusual for an executive of such a Canadian company to have come at some stage of his career from the United States. If he has retained his U.S. citizenship he may need help and not know it, for one of the prices of maintaining his U.S. citizenship is the payment of U.S. income tax even though he is not resident in the U.S.A. and derives no income from U.S. sources. As Canadians we may not think that this price is worth paying. However, a U.S. citizen seems to think otherwise and is seldom willing to give up his citizenship to save even substantial amounts of tax.

If he intends to divest himself of his citizenship, he should be careful not to dispose of any of his investments and other capital assets which will realize capital gains until after he has established residence in Canada and is no longer a U.S. citizen. But this article is intended to deal with the tax position of persons who choose to remain U.S. citizens while they are resident in Canada.

There are many simple ways of minimizing U.S. as well as Canadian taxes of U.S. citizens resident in Canada, which every chartered accountant practising in Canada should know.

Canadian Tax

Article VII of Canada-U.S. Reciprocal Tax Convention

A U.S. citizen taking employment in Canada in the last half of the taxation year could avoid Canadian taxes for that year by bringing himself within Article VII of the Canada-U.S. Reciprocal Tax Convention. He could do this by not taking up residence in Canada until the January following the commencement of his Canadian employment in any case where he would not be in Canada for more than 183 days in the first year of his Canadian employment and his compensation from such employment for that year would not exceed $5,000.

Part-time resident

If he became a resident in Canada during the first year of his employ-

ment, he would be taxable for that year under section 29 of the Income Tax Act as a part-time resident of Canada. Thus he would be obliged to report only his income received while he was resident or employed in Canada, and would be entitled to deduct only a pro rata portion of his personal exemptions and other deductions.

Income from U.S.A. earned before but received after coming to Canada

Because the Income Tax Act of Canada taxes earnings from employment at the time they are received, a U.S. citizen intending to become resident in Canada should consider not doing so until he has received all his remuneration and other benefits from his U.S. employment.

For example, if after he became resident in Canada he received a single payment retirement allowance or a lump sum settlement of his interest in a pension fund as a result of his former U.S. employment, the amount received would be subject to tax in Canada less a credit in respect of the applicable U.S. tax.

United States Tax

Taxation of non-resident citizens compared to treatment under Canadian law

A Canadian citizen who is not resident in Canada at any time in the taxation year is not taxable in Canada under Part I of the Income Tax Act unless at any time in the year

(a) he was employed in Canada, or

(b) he carried on business in Canada.

If he receives investment income from Canadian sources, he is subject to the 15% non-resident withholding tax under Part III of the Income Tax Act in the same manner as if he were not a Canadian citizen.

On the other hand, the United States Internal Revenue Code imposes income tax on all citizens of the United States whether or not they be resident in the United States. A non-resident U.S. citizen must file a U.S. income tax return annually and include therein his world income, except compensation for services performed outside of the United States which comes within the exemption in section 911 of the Code. Such compensation, other than amounts received from the United States or any agency,

(a) is totally exempt if he is a bona fide non-resident for an uninterrupted period which includes an entire taxable year and the compensation is attributable to such period, and

(b) is exempt to the extent of $20,000 for a full taxable year, or a pro rata portion thereof for a part taxable year, if the compensation received was attributable to a period of 18 consecutive months during which he was outside the United States for at least 510 days.

For the purposes of this exemption, a taxpayer engaged in a trade or business in which both personal services and capital are material income producing factors is entitled to treat as compensation for personal services rendered by him a reasonable allowance not exceeding 30% of his share of the net profits of the trade or business.

It should be noted that compensation for services performed abroad which comes within the exemption under section 911 of the Code is

exempt even if it is not received until after the citizen returns to the United States.

As income under the U.S. Internal Revenue Code includes capital gains, U.S. citizens resident in Canada are taxable in the United States on capital gains realized in Canada.

Credit for Canadian tax on income taxed in Canada but not in U.S.A. against U.S. tax on income taxed in U.S.A. but not in Canada

Under the U.S. Internal Revenue Code, a taxpayer is entitled to claim a foreign tax credit in respect of income from Canadian sources taxable in the U.S.A. even though the Canadian tax was paid on income which the taxpayer is not required to include in his U.S. return.

For example, although capital gains are not taxed in Canada, the U.S. tax on capital gains derived in Canada by a U.S. citizen resident in Canada may be reduced by a foreign tax claim in respect of the Canadian tax paid on his remuneration from Canadian employment although such remuneration is not taxed in the U.S.A.

The way is also open for making elections under Part II of the Income Tax Act to pay 15% tax on undistributed income, and the payment of a stock dividend in redeemable preferred shares, where a U.S. citizen resident in Canada is a principal shareholder. The U.S. Code exempts stock dividends from taxation, but on the redemption of preferred shares received by stock dividend (other than on the disposition of all of his holdings in the company) ordinary income would result to the extent that the stock dividend would have been required to be included in income if, at the time it was paid, cash had been received by him instead of stock. This means that the redemption would be taxable to the extent of the shareholder's equity in the company's undistributed income at the time the stock dividend was paid. By arranging redemptions of the preferred shares in annual amounts approximating his income from Canadian employment, the U.S. citizen would end up paying little or no U.S. tax on the deemed dividends arising from the preferred stock redemptions. The tax otherwise payable would be offset by the foreign tax credit arising from the payment of Canadian tax on his income from employment in Canada.

Employee's stock option benefits

A U.S. citizen resident in Canada should make sure of his U.S. tax position before exercising a stock option granted to him by his Canadian employer. The benefits under the Canadian Income Tax Act might under certain circumstances be offset by the imposition of U.S. tax. The Canadian Act taxes the benefit from a stock option at the time the option is exercised, whereas under the U.S. code how the benefit is taxed depends upon whether the option comes within the definition of a "restricted stock option".

It is not proposed to deal with all the complicated provisions of the U.S. Internal Revenue Code relating to employee's stock options. It is sufficient to say that under the U.S. Code no income is deemed to have been received upon the exercise of a "restricted stock option", but under certain circumstances upon the sale of the stock or upon his death an employee may be required to include in his ordinary income as compensation part or all of the profit on the sale, and the part of the profit which is

not treated as compensation is treated as capital gain.

If the option is not a "restricted stock option" the general rule is that the employee must include in his ordinary income as compensation the entire amount by which the purchase price is exceeded by the fair market value of the stock when the option is exercised. However, if the option is transferable and has value when granted, the value of the option may be taxable at the time it is granted.

A U.S. citizen exercising a stock option granted by his Canadian employer may be subject to U.S. capital gains tax on part or all of the profit realized when the stock is sold. However, if he sells his stock while still employed in Canada, he may be able to minimize the U.S. capital gains tax by claiming a credit for the Canadian tax on his Canadian remuneration.

Employees profit sharing plan

Under the U.S. Internal Revenue Code, a taxpayer is taxable on the benefits distributed or made available to him out of a qualified employees profit sharing trust to the extent that they exceed his contributions. If he receives repayment of all of his interest in the trust in one year because of death or separation from employment, but not otherwise, the taxable amount is treated as a long term capital gain. If he receives his interest in the form of an annuity, the income portion of the benefits are taxed according to the rules applicable to annuities. A lump sum distribution received while he continues in the company's service is treated as ordinary income.

The above is modified by the employees' death benefit rule set out in section 101(b) of the Code in the case of payments made by reason of the death of an employee. Where this rule applies

(a) the first $5,000 of a lump sum payment is completely tax-free, and

(b) if the benefits are taken as an annuity, up to $5,000 (depending upon the amount by which the value of the annuity exceeds the employee's non-forfeitable rights) may be considered additional cost basis for the annuitant and so be recovered tax-free over the annuitant's life expectancy.

If the amounts received from a plan include securities of the employer corporation, the benefits distributed or made available to the employee do not include net unrealized appreciation in such securities if the taxable amount of the distribution is treated as a capital gain. Otherwise, only the net unrealized appreciation attributable to the amount contributed by the employee is excluded from the benefit. The appreciation is realized only when the securities are sold, and is then taxed as a capital gain in the year of sale.

Because of section 402(c) of the Code, the above also applies to benefits received from a profit sharing trust organized outside of the United States if the trust would have qualified had it been organized in the United States.

The Canadian Income Tax Act requires an employee to include in his income amounts allocated in the year to him contingently or absolutely otherwise than in respect of his own contributions or capital gains made by the trust. Amounts received by the employee from the plan are exempt from Canadian tax, since he is taxed on the employer's contributions and his share of the earnings

of the trust at the time of allocation.

An employee who is a U.S. citizen resident in Canada may thus find himself in the position of being taxed in Canada in the year the trustee allocates an amount to him and in the United States on at least part of the benefits which are paid to him. Assuming that he was entitled to the exemption on remuneration from his Canadian employment under section 911 of the Code, he would be entitled to exclude from his income distributions attributable to contributions made by his employer while he was resident in Canada, but this exclusion would not apply to investment income, capital gains and other accretions earned by the fund. For this purpose

(a) if he received current distributions from the plan so that the annuity treatment applied, his Canadian employer's contributions would be treated as if he had himself made the contributions, and he would be entitled to an exemption in respect of the annuity payments having regard to the total of such contributions and his own actual contributions; and

(b) if he received a lump-sum capital gain distribution, his employer's contributions made while he was resident in Canada are considered to be part of his cost in measuring the amount of the capital gain.

While the tax treatment would be the same whether the employee received the distributions while still a resident of Canada or after he had returned to the United States, it should be noted that in the latter event he probably would have no Canadian tax credit available to offset his U.S. tax. Furthermore if the fund had been built up over a period of 20 years or so, there would likely be such a substantial amount of undistributed income, capital gains and other accretions in the fund that a large part of the distribution would be taxable even though all contributions were made while the employee was resident in Canada.

It would therefore seem that some thought should be given as to the timing of the distributions so that the U.S. tax might be offset to the greatest extent possible by the foreign tax credit arising from the Canadian tax paid on his remuneration from his Canadian employment in the year of the distribution.

Employees pension plan

What is said about the U.S. tax treatment of payments from a qualified employees profit sharing plan applies also to payments made from a qualified employees pension plan.

However, under the Canadian Act, pension plan payments are treated much differently from payments from a profit sharing plan. If the employee receives a pension from the plan, he is taxable on the pension-payments until such time as he returns to the United States. If he receives a lump sum payment in satisfaction of all his interest in a plan he may elect to pay tax on the basis of his average rate for the three years preceding the year of payment in lieu of including the payments in his income of that year.

There would appear to be no particular difficulty in the case of such a lump sum payment because he could deduct from his U.S. tax on the taxable portion of the payments a credit for the Canadian tax paid on the whole of the payments.

If he receives a pension from the plan while still resident in Canada, a portion of the payments would be taxable in the United States on the annuity basis, but he would be able to offset the Canadian tax paid on the whole of the payments.

Pension payments received after returning to the United States are exempt from taxation in Canada under Article VIA of the Reciprocal Tax Convention, so he would have no Canadian tax to offset against his U.S. tax on the taxable portion of the payments.

PROFIT AND LOSS

Contrary to popular belief, accountancy is not all figures; sometimes it is a question of facts, and they can be just as fallacious.

One of my clients came to me and said, "You're an accountant. Work this one out. My wife went out and bought a new hat. She came back and said, "It didn't cost me a farthing. It was marked down from £10 to £5, so I bought it with the £5 I saved."

What did I do? Well, falling back on first principles, I took him as far away from his question as possible and told him the story of St. Peter standing inside the Golden Gates when he heard a very subdued knock on the gates. A little puzzled, he opened them and found Mr. Krushchev standing there, looking very dejected. A little surprised, he asked, "What do you want here; this is not the place for you." "Please sir," came the reply in very humble tones, "May we have our ball back?"

—From a toast proposed by A. C. S. Meynell, president, at the annual dinner of the Association of Certified and Corporate Accountants; published in *The Accountants Journal*, January 1958.

An International View of the Accounting Profession

A review by H. C. Dixon, F.C.A. of papers presented at the Seventh International Congress of Accountants, Amsterdam, Sept. 1957

AT THE SEVENTH International Congress of Accountants held last September in Amsterdam, papers were read by accountants from England, United States, Sweden, the Netherlands and Germany, on the general subject of "Principles for the Accountant's Profession". It is interesting to see how our fellow practitioners in other countries have developed the profession.

The Institute of Chartered Accountants in England and Wales was represented by Sir Thomas B. Robson, M.B.E., M.A., F.C.A. Carman G. Blough, M.A., LL.D., C.P.A. spoke for the American Institute of Certified Public Accountants. The profession in Sweden was discussed by Oiar I. Cassel, Civ. Ekonom, and A. Th. de Lange, Ec. Drs. spoke for the Netherlands. Dr. Heinrich Wollert presented the German viewpoint.

Objectives of the Public Accountant

In describing the function of the profession, all of the authors appear to be on common ground, although naturally there is some difference in emphasis. "Truth and fairness", says Sir Thomas Robson, "should be the outstanding characteristics of our profession everywhere." In a similar vein Carman Blough says: "Certified public accountants in the United States have gained their position of high regard mainly because they have met the needs of present and prospective investors and credit grantors for an independent report which can be relied upon as assurance that the representations of the management of an enterprise, as set forth in the financial statements, are dependable." As long ago as 1912, another United States practitioner, Robert H. Montgomery, put this in fewer words: "The prime purpose of auditing is the discovery and disclosure of truth." Cassel speaks of the practising accountant as one "on whose impartial judgment we can rely". De Lange stresses the need in the Netherlands for the "judgment of an independent expert".

The profession in Germany is described somewhat differently. "Accountancy as a professional institution", says Dr. Wollert, "was established in Germany as a result of the shock of the financial crisis of the years 1931 and 1932." In its 26 years of life, however, it has evidently become a permanent feature of the German economy.

Legal Requirements

One would expect to find that in all of the countries represented, an annual audit would be required at least for all public companies. It is surprising therefore to find that in the Netherlands there is no legal requirement that annual accounts of public companies should be audited and no statutory regulation of the accountancy profession. The development of the profession in that country has depended upon the initiative and sense of public responsibility of the members themselves.

Independence of the Auditor

There is unanimity on the importance of independence. The way in which this objective is achieved varies from detailed regulations in the German law to complete reliance on the professional integrity of the individual practitioner in the Netherlands. Most Canadian accountants are familiar with the stringent regulations of the Securities and Exchange Commission of the United States on this subject. In Sweden and in the United Kingdom, company law provides that no director or employee of a company may act as its auditor. There seems to be no doubt that the question of independence is given top priority as a professional qualification in all of the countries represented in this discussion.

Auditor's Report

There is a wide divergence of views among the various authors as to the desirable form and content of an auditor's report on the accounts of a public company. Canadian practitioners will not be surprised that the fullest statement on this subject is in Carman Blough's paper dealing with United States practice. Mr. Blough does not deal with legal responsibility but intimates that the demands of accepted standards go farther than the legal requirements. He points out that the American practitioner indicates the nature of the work he has performed and the responsibility he takes for the fairness of the financial statements with which he permits his name to be associated. The practitioner reports that the financial statements are presented in accordance with generally accepted principles of accounting and that such principles have been consistently observed in the current period in relation to the preceding period. Sir Thomas Robson, on the other hand, suggests that the report "should be reduced to saying whether in the opinion of the auditor, subject to any reservations stated in the report, the accounts show a true and fair view of the state of the company's affairs as at the date of the balance sheet and of the profit or loss for the year, or other financial period, ended on that date". He does not consider that under normal circumstances it is necessary for the report to define the scope of the auditor's examination.

In Sweden, the auditor is required to enumerate in some detail the scope of his examination. He is required by the governing statute to make any criticism he deems appropriate as to the administration of the company's affairs, quite apart from his general approval of the financial position and statement of earnings. Dr. Cassels suggests that this unusual requirement may get the auditor into trouble as he can be ordered to pay compensation for damage suffered by the company as a result of any disparaging remarks which he may have made but cannot support.

In the absence of legal requirements for an audit in the Netherlands, the form of the report is left to the discretion of the individual practitioner. De Lange takes a rather extreme view of this position: "Auditors are urged to formulate the conclusions they arrive at in the simplest possible terms; after auditing the annual accounts of an undertaking it should be sufficient for the auditor to state simply that he has found them correct or merely to apply his signature." The auditor's responsibility as in other countries is determined in the last analysis by the conventions which are generally accepted in the profession.

In Germany, the duties of the auditor are codified in considerable detail and the auditor is therefore required to report that the financial statements "correspond to the legal regulations". Nevertheless Dr. Wollert insists that in compulsory audits the compulsion exercised by law does not result in narrowing down the margin of judgment available to the auditor.

Scope of the Audit

In spite of the variations in legal requirements there is much similarity in the various points of view presented regarding the duties of the auditor. In the United Kingdom he must make examination of such a nature and extent as to enable him properly to give a report on the financial statements. The *Kingston Cotton Mill* case of 1896 is still quoted as the measure of the auditor's responsibility:

> It is the duty of an auditor to bring to bear on the work he has to perform a skill, care and caution which a reasonably competent, careful and cautious auditor would use. What is reasonable skill, care and caution must depend on the particular circumstances in each case.

We assume that the interpretation of the phrase "the particular circumstances of each case" will be different now from what was the case in 1896. The auditor's conception of his responsibility for inventories, for example, has developed considerably between the time of the *Kingston Cotton Mill* case and the time of the *McKesson, Robbins* hearing in the United States.

We find the same insistence on the importance of the system of internal control supplemented by test checking of transactions in Sir Thomas Robson's article as is found in Mr. Blough's discussion of United States practice. In Sweden, however, there is evidently a much greater emphasis on a relatively full examination as opposed to test-audits.

Education and Training

Perhaps the greatest variation of all is found in the field of education and training. The Institute of Chartered Accountants of England and Wales requires a prospective member to have a good standard of general education. He must spend a minimum of five years in obtaining practical experience as an apprentice, during which time he must pass two professional examinations set by the Institute. The examinations cover accounting principles, auditing, taxation, costing, general commercial and financial knowledge and law relating to companies, liquidations, receiverships, contracts, bankruptcy, trust, etc.

In the United States, while university graduation is not required in all States, Mr. Blough considers that the trend for the future is in the direction

of more extensive training in colleges and universities and less practical experience as a preparation for the practice of public accountancy. A special commission set up by the Institute reported last year after four years of study on "Standards of Education and Experience for Certified Public Accountants". The commission's recommendations anticipated the development of professional instruction on a post-graduate basis with limited internship programs. The Institute has not yet reached a definite conclusion regarding these recommendations. While separate educational programs are carried on by individual State societies, each of them uses the same C.P.A. final examination set by the American Institute of Certified Public Accountants.

In Sweden, in order to become an "Authorized Public Accountant" the student qualifies for a degree at a Swedish College of Economics. This involves a course of study of some 3½ years, including business administration, law and economics. A further five years of successful practical experience is required. There is no form of accountancy examination but when the required experience has been obtained the student may apply to a Chamber of Commerce to be admitted as an authorized public accountant. The application is supported by a testimonial from his employer.

In the Netherlands an accountant's diploma can be obtained either by passing the accountancy examinations at an institution for higher education or by passing the examinations of the Netherlands Institute of Accountants. The Institute conducts courses and sets examinations for students who have had no education beyond secondary school.

In Germany the candidate for the designation "authorized public accountant" must show that he is suitable for the responsible position of accountant, that he is living in settled financial circumstances, that he is at least 30 years of age, and that he has completed six years of practical work, four of which were in the profession. He must also have a university degree in economics, science, law or engineering. When these qualifications are obtained the candidate must write a thesis and submit to two written examinations and one oral examination. After having passed the examinations the candidate may be invested in the profession by the competent governmental authority. He then takes the following oath:

> I swear that I shall fulfil the tasks and duties of an authorized public accountant conscientiously and impartially; that I shall keep the professional secret and I shall render the expert opinion required of me conscientiously and impartially.

Rules of Professional Conduct

In the five countries under discussion the profession thinks along similar lines with regard to its ethics but there is some differences in the approach to the problem. In the United Kingdom there is no written code, but a tradition of professional conduct has developed. The professional society may take disciplinary action which may result in the loss of the professional designation. Speaking for the United States position, Mr. Blough insists that the individual accountant should not set his own standards of professional conduct but that there should be written rules or

regulations of professional organizations or of governmental bodies.

In Sweden and in Germany, there are regulations of both the governmental bodies and the professional societies which must be observed. In the Netherlands, the professional societies make their own regulations but they are general statements of principle of professional practice rather than specific rules of conduct.

In all of the countries concerned, advertising and direct solicitation of business is considered to be unprofessional. In the United Kingdom, as in the United States, contrary to the practice elsewhere, the use of heavy type in directories and the insertion in newspapers of professional cards is not tolerated.

It is a generally accepted principle in all of these countries that the auditor should not accept an engagement without first ascertaining the circumstances under which the engagement of his predecessor was terminated, and whether there is any professional reason why he should not accept the engagement. It is also generally recognized that the setting of fees contingent upon the result of the work is unprofessional.

Conclusion

The historical background of the profession in the various countries has been different, and this has resulted in differences of emphasis as it has developed. Nevetheless, a review of these papers leaves one with the impression in all cases that the profession is striving for the same essential objectives. The professional societies appear to be taking the lead in establishing high standards of education, professional competence and ethics.

The authors all recognize that the profession has international obligations and that it is most desirable that practitioners should be able to understand and rely upon the reports of their counterparts in foreign countries. As Dr. Wollert suggests, it should be the aim of all of us to achieve a standard of professional practice which will have international acceptance, thus making some contribution toward bringing the nations more closely together.

Recommendations on the Income Tax Act

Joint Recommendations on the Income Tax Act submitted by the Canadian Bar Association and the Canadian Institute of Chartered Accountants

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The 1958 recommendations for amendments to the Income Tax Act, as contained in the joint brief of the Canadian Bar Association and The Canadian Institute of Chartered Accountants, cover a somewhat wider field than in the immediately preceding years. New features include a timely protest against the encroachment of "case-made law" into the field of permissible deductions, elective taxation for professional firms on corporation basis and the advocacy of advance tax rulings.

Into a climate of new government, new brooms, etc., it was thought advisable to replant some of the older suggestions which had withered from previous briefs but which were felt to be fundamentally sound. In order to broaden the sources of the material from which recommendations are made, the membership at large was invited to forward their suggestions and a number of useful ones were received.

Arising as it does from the close contact with the problems of taxpayers by the two petitioning professions, this material is objectively prepared and represents an "upward force" intended not to reduce the tax burden but to ensure its even and equitable application as between taxpayers. Some progress in this direction has been made each year in the past and the respective committees are encouraged to hope that the efforts put forward this year will have even better results.

PART I

DEEMED INCOME OF A SHAREHOLDER

Section 8(1)(2)

Section 8(1) provides that certain payments, benefits and loans received by a shareholder from a company shall be included in the income of the shareholder. Further, the Act does not specifically provide that the undistributed income of the company is to be reduced by the amounts included in the incomes of shareholders under section 8(1) or section 8(2).

Recommendation: It is recommended:

(a) That all amounts included in the incomes of shareholders by reason of section 8(1) should be deemed to be dividends and consequently should carry with them the benefit of the 20% dividend tax credit and should also be tax-free in the hands of a shareholder which is a corporation except in

cases where section 28(2) is applicable.

(b) That the undistributed income on hand of the corporation should be reduced by all amounts included in the incomes of its shareholders by reason of section 8(1) or section 8(2).

(c) That section 8(2) should not apply unless the loan has remained outstanding more than 30 days after the corporation has been notified by the Minister that he proposes to invoke this provision.

DEDUCTION OF INTEREST ON FIXED TERM DEBT ISSUED AT DISCOUNT

Section 11(1)(c) and 11(1)(cb)

Under section 11(1)(c) a deduction is permitted of the amount of interest (to the extent that it is reasonable)

(1) upon borrowed money used for the purpose of earning income from a business or property, and

(2) upon money payable for property acquired for the purpose of gaining or producing income therefrom or from a business . . . .

While certain expenses of borrowing money are deductible under 11(1)(cb), where bonds or debentures to secure a loan are issued at a discount, i.e. for less than the amount repayable by the borrower, the borrower is allowed no deduction for the amount of the discount despite the fact that it is as much a cost of the loan as is the interest thereon. Further, that part of the discount which is the underwriters' commission is taxable in his hands.

Recommendation: It is recommended that a deduction for such charges as are mentioned above should be allowed in the cases of bonds, debentures and other fixed term debt issued on a basis whereby the same are not convertible into share capital, by amending section 11(1)(c) or 11(1)(cb)

to permit the deduction of discount and/or underwriters' commission on bonds, debentures or other fixed term debt (excluding debt issued on a convertible basis) not exceeding 5% of the face amount of the security.

DEDUCTIBILITY OF BUSINESS EXPENSES

Section 12(1)(a) and 12(1)(b)

Liability for income tax under our law is measured by "taxable income" which is, generally speaking, net income minus certain deductions from income which are allowed in arriving at taxable income. Net income is arrived at by deducting from the amounts included in income certain expenditures and allowances. However, by reason of specific provisions in the Act and a long series of judicial decisions in England and Canada, the expenses allowed in arriving at income for tax purposes are severely limited. Many expenses which would be deducted in arriving at income under accepted accounting practices and as a matter of common sense are disallowed for income tax purposes. The result, particularly in view of the present high rates of taxation, is to create inequities and hardship upon taxpayers which incur substantial bona fide business expenses which, for some technical reason, are not allowed as deductions.

The principal difficulties arise from sections 12(1)(a) and 12(1)(b) of the Act. These provisions have been adopted, with certain changes in wording, from corresponding provisions in the British Income Tax Act.

The provision in the British Income Tax Act which corresponds with section 12(1)(a) provides that no sum shall be deductible in respect of disbursements or expenses not wholly and exclusively laid out or expended for the purposes of the trade. In dealing with this provision in 1906 in the House of Lords decision in *Strong* v. *Woodifield,* Lord Davey made the statement that "it is not enough that the disbursement is made in the course of, or arises out of, or is connected with the trade or is made out of the profits of the trade. It must be made for the purpose of earning profits." This statement has been quoted and relied on by the courts many times since 1906. In the 1955 Report of the British Royal Commission on the Taxation of Profits and Income it was recommended that the restricted meaning applied to the statutory provisions because of this statement by Lord Davey should be removed by statute. No legislation has as yet been introduced in England to carry out this recommendation. It may be observed that the wording of section 12(1)(a) is more restrictive than the corresponding British provision and in fact is very similar to Lord Davey's test for the application of the British provision.

The following are examples of expenses, the deduction of which has been disallowed in Canada:

(1) The cost of special surveys and cruises required by a provincial statute to be made on timber limits leased from a provincial government – *K.V.P. Company Limited* v. *M.N.R.* (Ex. Ct., 1957).

(2) Payments made by a transportation company to certain municipalities to enable them to improve their local roads, the payments having been made as a condition of obtaining an order from a provincial Public Utilities Commission – *British Columbia Electric Railway Company* v. *M.N.R.* (Ex. Ct., 1957).

(3) A payment made by a mining company to a power company in consideration for the latter extending a power line to a mine in a remote area – *Ormiston Mining and Smelting Company Limited* v. *M.N.R.* (ITAB, 1957). This specific type of expenditure is now allowed as a deduction under section 11(15) which was enacted in 1957.

(4) A commission paid by the purchaser of an exclusive distributorship to the vendor thereof at the rate of 2c per foot of the product sold – *No. 383* v. *M.N.R.* (ITAB, 1957).

(5) Travelling expenses of a taxpayer and his employee incurred on a trip made to acquire knowledge of a particular technique – *Birch* v. *M.N.R.* (ITAB, 1956). This case raises the question of whether the cost of education should be deductible or depreciable. It also raises the question whether continuing education of individuals such as professional men who require such education for the purpose of their businesses or the education by an employer of its employees, should be distinguished from the initial basic education of an individual.

(6) The price paid to a contractor to acquire from him a construction contract – *No. 392* v. *M.N.R.* (ITAB, 1957).

(7) Legal fees and disbursements paid to obtain a favourable modification of the Customs Tariff affecting materials imported by the taxpayer– *Arrco Playing Cards Company (Canada) Limited* v. *M.N.R.* (Ex. Ct., 1957).

(8) Expenses of a libel action where the alleged libel related to the way in which the taxpayer's business was carried on – *William F. Koch Laboratories of Canada Limited* v. *M.N.R.* (ITAB, 1956).

(9) Promotional expenses incurred on behalf of subsidiary companies – *Canadian Ice Machine Company Limited* v. *M.N.R.* (ITAB, 1957).

(10) Payments made by shipping companies to secure the cancellation of charters of ships in order to avoid a loss or to permit the ship to be chartered on a more profitable basis – *Halifax Overseas Freighters Limited* v. *M.N.R.*, *Bedford Overseas Freighters Limited* v. *M.N.R.*, and *Falaise Steamship Company Limited* v. *M.N.R.* (ITAB, 1957).

Most of the above cases were decided in Canada within the last year. The list could be supplemented indefinitely by going back to previous years. While some of these cases are under appeal and while some of the inequities and hardships might be ameliorated by judicial decision, it is submitted that any substantial improvement of the law relating to deductions is unlikely from this source and in any event would only be a partial solution. It is submitted that the entire subject of deductions should be reviewed and re-examined and that the Income Tax Act should be amended in such a way as to permit the deduction of bona fide expenses incurred in connection with the operation of a business or property.

We would suggest that expenses which are disallowed for tax purposes should generally speaking be confined to the following classes:

(a) Expenses made to acquire a capital asset where the value of the asset will diminish over a period, in which case, the cost should be allowed over a number of years as depreciation, depletion or amortization.

(b) Expenses made to acquire a capital asset or benefit which will not depreciate in value such as land.

(c) Expenses made to earn certain types of exempt income.

(d) Expenses which are not related to a business, or to a property held for the production of income.

The revenue is partly protected in respect of these types of expenses by section 12(1)(c) which prohibits the deduction of expenses made to earn exempt income, section 12(1)(h) which prohibits the deduction of personal or living expenses and section 12(2) which prohibits the deduction of unreasonable expenses. Some additional protection is required in sections 12(1)(a) and 12(1)(b), but it is submitted that these provisions as construed by the courts are much too restrictive and, as indicated above, create inequities and hardship.

Recommendation: It is recommended that paragraphs (a) and (b) of section 12(1) be amended so as to read somewhat as follows:

(a) an outlay or expense except to the extent that it was made or incurred in connection with the taxpayer's property or business which has been acquired or is operated for the purpose of gaining or producing income.

(b) an outlay made to acquire a capital asset or advantage which by its nature will endure indefinitely or in respect of which allowances may be deducted under this Part, except to the extent of such allowances.

FARMING AS CHIEF SOURCE OF INCOME

Sections 13 and 42

It sometimes occurs that farm losses are disallowed when farming is unquestionably being carried on as a profit making venture with no element of a hobby nature involved in the farming. The same is true with respect to averaging under section 42.

Recommendation: It is recommended that these sections be reviewed and revised to eliminate inequities which do occur because of the interpretation being placed on the phrase "chief source of income".

METHOD OF COMPUTING INCOME

Section 14(1)

Recent jurisprudence appears to have rendered the meaning of section 14(1) obscure, especially as regards "accepted for the purposes of this part". There is also uncertainty regarding the meaning of the words "method for computing income from a business or property".

The reported decisions *Ken Steeves Sales Limited* v. *M.N.R.* and *No. 282* v. *M.N.R.* indicated that some doubt existed as to whether a method of computing income can *ever* be accepted by the Minister in view of his right to reassess. If this doubt is justified the effect of section 14(1) would be nullified and a method of computing income could never be considered adopted and accepted so as to bind either the taxpayer or the Minister in future years.

Recommendation: It is recommended that provisions should be introduced to the effect that:

> a method of computing income is deemed to be accepted for the purpose of section 14(1) if the Minister accepts such method in writing or if the method has not been rejected by the Minister within four years after the receipt of the original assessment for the first year in which the taxpayer adopted that method.

LEASE OPTION AGREEMENTS

Section 18

The principal objection to this provision is that it applies in the case of every lease which includes an option to purchase, even though it may be clear that the rental payments do not in fact contain any element of instalment payment on the purchase price. In such cases the special lease-option treatment frequently results in unfair deferment of deductions for rental payments, particularly in cases where the option to purchase may not be exercised, and may result in denial of any deduction whatever where non-depreciable property is involved.

In addition, these provisions are unsatisfactory in a number of other respects. Capital cost of the property deemed acquired by the lessee is not adequately defined, particularly where the option to purchase may be exercised at more than one date during the term of the lease. Nor is there any provision dealing with the division of the deemed cost between depreciable and non-depreciable property, although this is required in order to ensure an equitable result to the lessee.

A deduction should be denied for any part of rental payments which may reasonably be regarded as payments for a right or option to purchase at a favourable price in the future. However, it is suggested that this object would be achieved through the application of the general principles of determination of in-

come, and the special provisions are not required.

Recommendation: Repeal of section 18 is recommended.

Alternatively it is recommended that the provisions of section 18 should not apply in the case of real property if the option price fixed by the agreement is not less than the fair market value of the property at the time the agreement is made.

BUSINESS LOSSES

Section 27(1)(e)

A taxpayer is now entitled to the benefit of this section only in a case where its income for the taxation year is derived from the same business in which the loss was sustained.

An individual taxpayer who has been unsuccessful in one type of business should be permitted to engage in another or completely new type of business without risk of losing the privilege of the loss-carry-over provisions. Similar treatment should be accorded a corporate taxpayer so long as control of the share capital of the company does not change. It seems unreasonable that a loss from one business can be deducted from the income of another business of the taxpayer which was earned in the same taxation year as the loss was incurred, while a deduction may be denied if the loss was incurred in one year and the income was earned in the following year.

It would also seem that a company should be entitled to the benefit of the section in cases where control has changed but a loss has been incurred from the same business as that from which the income is earned.

Recommendation: It is, therefore, recommended that section 27(1)(e) be amended so that the offset of losses of a taxation year against the profits of the previous taxation year, or the immediately 5 succeeding taxation years, would be denied only if the taxpayer is a corporation and both of these two disqualifying provisions become applicable:

(1) Control of more than 50% of the shares of the corporation are acquired by a new group of shareholders at an arm's length transaction, and
(2) The type of business carried on by the taxpayer is changed.

DESIGNATED SURPLUS

Section 28(2) et seq.

We understand that the purpose of subsections (2) to (9b) of section 28 was to prevent one corporation from purchasing shares of another corporation in an arm's length transaction and then having the controlled corporation distribute its undistributed income on hand to the controlling corporation by way of tax-free dividend. We submit that this purpose is not applicable where the corporations both before and after the purchase are members of a group of companies having common control. The provisions result in rigidity in the organization of groups of companies and impose an obstacle in the way of reorganizations which should take place from a business point of view.

This view is supported to some extent by the exception to the operation of these provisions contained in subsection (9a) which was introduced in 1953 and was expanded to some extent in 1957. It is submitted that this exception is entirely too narrow. It does not apply, for example, in a case in which a sub-subsidiary acquires control of another sub-subsidiary of the same parent corporation. Sim-

ilarly, it does not apply where a parent corporation acquires from a subsidiary corporation the shares of a sub-subsidiary. In our view, there is no reasonable ground for distinction between these cases and those which are provided for in subsection (9a).

Recommendation: We recommend that section 28 be amended to provide that control of one corporation shall be deemed not to have been acquired by another if control was acquired in a non-arm's length transaction.

FOREIGN TAX CREDIT

Section 41

The deduction for foreign tax on income of a Canadian resident is limited under section 41(1)(b), to the proportion of the tax otherwise payable under Part I that the foreign income (other than exempt income) is of his entire income for the year (other than exempt income). This limitation unfairly restricts the deduction for foreign tax in cases where the tax otherwise payable is reduced by reason of

(a) a credit under section 38 for dividends from taxable Canadian corporations;
(b) a deduction for business losses of other years.

These deductions may not reduce the tax imposed under Part I on the foreign income, and thus should not affect the amount of foreign tax allowed as a deduction.

A similar situation exists in connection with income of a foreign branch of a Canadian corporation. The income of the foreign branch is subject to the full rates of tax under Part I and is not eligible for a deduction under section 40 for provincial tax. The credit allowed for foreign tax on such income is, however, limited to the average rate of tax under Part I after taking deductions for provincial tax into account. *Recommendation*: The limitation on the deduction for foreign tax contained in section 41(1)(b) should be amended to ensure that the deduction will not be affected by deductions and credits allowed in respect of other income. It is felt that foreign taxes should be deductible up to the amount by which the tax under Part I was increased by reason of the foreign income.

On a broader scale, inequities arise by reason of the fact that the withholding tax in income paid to non-residents is charged on the gross amount of income paid, without deductions of any kind. There is no doubt that the latter feature is taken into account in fixing the rate of tax which is in most cases 15%. Foreign countries, such as the United States, follow the same procedure when charging withholding tax on income from United States sources paid to Canadian residents. Interest income, for example, received by a Canadian taxpayer from a United States payer is subject to a U.S. withholding tax of 15% at the source and is also subject to ordinary rates of tax in the recipient's Canadian return. In computing the foreign tax credit allowed to a Canadian taxpayer, it is the practice of the Division to disallow a portion of the foreign tax deemed applicable to an amount of income equal to the amount of expenses considered applicable to the foreign income. To the extent of this disallowance the income is subject to taxation that seems unjustified. It is recommended that this section be amended to provide relief.

"NIL" ASSESSMENTS AND ASSESSMENT OF LOSSES

Section 46

It was held by the Supreme Court of Canada in 1955 in *Okalta Oils Limited* v. *M.N.R.* that a "nil" assessment is not an assessment and that no appeal can be taken from one. This has two unfortunate consequences:

(1) A taxpayer cannot appeal in respect of a loss year or a year in which no tax is payable and accordingly cannot have his tax position determined for such a year.

(2) The four year period leading to immunity from reassessment does not commence to run from the date of mailing of a "nil" assessment.

Section 42(2a) contains an exception to the above rule and provides that the provisions of the Act relating to assessment will apply to an assessment which shows no tax to be payable or that an overpayment has been made by a farmer or fisherman in the year of averaging.

Recommendation: It is recommended that the Act be amended to provide:

(a) that upon application in prescribed form a loss will be assessed and that such an assessment will be deemed to be an assessment for all purposes of the Act; and

(b) that a "nil" assessment will be deemed to be an assessment for the purposes of section 46(4)(b) and only for that purpose.

WHERE PAID-UP CAPITAL INCREASED

Section 81(8)

A strict reading of this section would appear to mean that the conversion of debentures and other liabilities into capital stock with a resulting increase in the paid-up capital would be deemed capitalization of undistributed income. The shareholders would be taxable to the extent of this capitalization. It does not seem reasonable that this should be the case and with the number of convertible debenture issues of the last few years it could be a matter of considerable importance. If such is a proper interpretation of this section, it is recommended that a revision be made to add to paragraph (b) of sub-section (8) following the word "assets" "and/or reduced the liabilities".

TAXATION ON UNDISTRIBUTED INCOME

Section 105

There are a number of inequities in the operation of section 105:

(1) In many cases the undistributed income of a company has been reduced since 1949 by large dividend payments or losses. However, no election can be made under section 105 unless it is first made on the entire undistributed income on hand at the end of the 1949 taxation year minus its tax-paid undistributed income at that time.

(2) In many cases where undistributed income has not been reduced since 1949 it is desired to elect to pay the 15% tax on less than the entire undistributed income at that time. If this were permissible an orderly program of elections over a period of years would be feasible.

(3) A subsidiary controlled corporation is not entitled to make an election under section 105(2) on dividends which were paid prior to the acquisition of control and

taxable in the hands of individual shareholders. This compounds the difficulties caused by the designated surplus provisions in section 28.

(4) It is cumbersome and expensive to go through the formalities of capitalization in order to distribute tax-paid undistributed income tax free.

Recommendation: It is recommended that:

(a) Section 105(1) be amended to permit one or more elections each on a portion of the undistributed income on hand at the end of the 1949 taxation year minus the tax-paid undistributed income at that time.

(b) Section 105(2) be amended to permit a subsidiary controlled corporation to elect to pay the 15% tax on dividends paid before it became a subsidiary controlled corporation and after 1949.

(c) The Act should be amended to permit a corporation to pay tax-free dividends out of tax-paid undistributed income. Provision should be made for the corporation to elect whether a particular dividend is paid out of tax-paid undistributed income or out of non-tax-paid undistributed income.

ARM'S LENGTH — IRREBUTTABLE PRESUMPTION

Section 139(5)

Section 139(5) provides that related persons shall be deemed not to deal with each other at arm's length and that it shall be a question of fact whether persons not related to each other were at a particular time dealing with each other at arm's length. It is submitted taxpayers should not be subject to taxation in Canada on the basis of relationships which are conclusively presumed to exist but which in many cases do not in fact exist.

Recommendation: It is recommended that, in place of the irrebuttable presumption that related persons as defined by subsections (5a) to (5d) and (6) of section 139 do not deal with each other at arm's length, the Act should provide that they shall be *presumed* not to deal with each other at arm's length so that the taxpayer may have the opportunity of rebutting the presumption by evidence satisfactory to a court of law.

UNINCORPORATED BUSINESSES

The tax advantages of carrying on business through a corporation are denied to a large group of taxpayers namely the professions because of the traditions of those professions as to personal liability. Therefore to equate the tax treatment, allow such persons or firms to elect to be taxed as if they were a corporation. Other businessmen outside the professional group have the opportunity of electing by the act of incorporation.

All the corporate provisions in the Income Tax Act dealing with undistributed income, etc., would apply upon winding up, or upon the revocation of the election.

This method of taxation has worked satisfactorily in the United States although it is not applied there to professional practitioners.

ADVANCE TAX RULINGS

Whatever defects may be found in the proposal hereunder, after considerable study, we believe that the principle of advance tax rulings is sound. Any taxpayer should be entitled to know what his tax liability

may be as a result of any proposed transaction at or near the time the transaction takes place and not many months or even years later when his income tax returns are finally assessed. If the Income Tax Act were clear and explicit in all cases this proposal would be unnecessary, but the Act is not. In the interest of foreknowledge and uniform assessment then this proposal is made.

It should be no more difficult for the Department to make advance rulings than it is to make assessments. As the Department must ultimately, in making an assessment, consider all the factors which are involved in an advance ruling, no addition to the burden or work in the Department is occasioned, just the timing of the work.

The following advantages to taxpayers and/or the income tax authorities, as well as benefits to the national economy, are likely to accrue from firm advance rulings from the authorities as to tax assessment of specific transactions proposed by taxpayers, namely:

(1) Advance knowledge of tax liability arising out of the specific transaction reduces business risk and thereby tends to encourage investment and business activity. Advance rulings tend to provide certainty as to the law and thereby aid business and other elements of the economy upon the normal activity on which the tax system is dependent.

(2) An advance ruling adversely affecting an important projected enterprise or raising an important question of tax law facilitates obtaining an early decision from the courts on a test transaction.

(3) An advance ruling tends to discourage transactions which are likely to result in expensive and fruitless tax controversies.

(4) An advance ruling facilitates the correct computation of taxes by taxpayers and thereby promotes voluntary compliance.

(5) Requests for advance rulings are an important source of information as to the tax-thinking of taxpayers and tax practitioners for the assistance of the authorities and laying the ground work for fair and economical tax administration.

(6) Requests for advance rulings facilitates the work of assessment by providing information much earlier than would otherwise be obtained.

(7) Publication of such advance rulings would promote uniformity of assessment and avoid multiplicity of applications on the same point.

The following recommendation is made:

(1) That the "Income Tax Act" be amended to provide authorization requiring the Minister of National Revenue through his designated officers to make advance rulings on the request of taxpayers as to the tax assessment which would result from specific prospective transactions.

(2) That in setting up the necessary administrative machinery the following principles be adopted:

(a) One central agency should be responsible for all advance rulings.

(b) Advance rulings should be issued only for specific prospective transactions based upon full disclosure of all

relevant facts and of all business reasons therefor.

(c) For all assessing purposes, an advance ruling should bind the Income Tax Department against making any assesssment less favourable to the applicant, where:

(i) There has been no misstatement or omission of material facts on the application;

(ii) the facts subsequently developed are not materially different from the facts on which the ruling was based; and

(iii) the taxpayer has acted in good faith in reliance on the ruling and a retroactive revocation would be to his detriment.

(d) Any advance ruling should be without prejudice to any of the rights of the applicant.

PART II

PAYMENTS BASED ON PRODUCTION OR USE

Section 6(j)

It is recommended that in connection with payments based on production or use, this section be amended to make it clear that capital payments received on the disposal of property are excluded from this section when the purchase price is definite and payable within a reasonable time.

DEDUCTION FOR SUCCESSION DUTIES — PENSIONS AND ANNUITIES

Section 11

Recommendation: It is recommended that the Income Tax Act be amended to provide that only the net amount received under a penison plan or annuity, that is, the amount remaining after deduction of the succession duty payable with respect thereto, should be treated as income of the recipient.

INTEREST ON SUCCESSION DUTIES

Section 11(1)(o)

It is recommended that this section be amended by the addition of the words "or interest actually paid on money borrowed for the specific purpose of paying succession duties or inheritance taxes, but not in excess of the interest rate that would be charged by the government to whom the duties were payable".

RESERVES

Section 12(1)(e)

It is recommended that:

(1) All uses of the word "reserve" in the Act, other than in sections 12(1)(e), 9, 11(4) and 30, be changed so that the terminology may conform with the now generally accepted accounting use of the word, and

(2) that the word "reserve", as used in sections 12(1)(e), 9, 11(4) and 30, be defined in the Act.

FISCAL YEAR-ENDS

Section 15(3)

At the present time, where a proprietor, as distinct from a partner, disposes of a business during a fiscal year, he has the right to elect that his fiscal period be deemed to have ended at the time it would ordinarily have ended.

This right of election, however, is not granted to partners but is granted only to proprietors.

An example of the above is where two partners are in business and their fiscal year ends February 28 and they dispose of their business on June 30.

Under the Income Tax Act the partners cannot elect to continue their fiscal period to the end of the normal fiscal period and are taxable on sixteen months' income. Had this example been a proprietor, under the Income Tax Act, he could elect to continue his fiscal period to the end of the normal fiscal period (section 15(3)).

Section 15(2) gives this right to members of partnerships in cases where the partnership is wound up by reason of the death or withdrawal of a partner or by reason of a new member being taken into the partnership.

Recommendation: It is recommended that this election be granted to partners as well as to proprietors.

INDIRECT PAYMENTS
Section 16(1)

The scope of this section is so wide that almost any payment made by a corporation could be brought within this section on the assumption that any payment is a benefit. Since the wording does not confine the payments, etc., to persons not dealing at arm's length or to transactions other than at "fair value", we believe that the legal effect of the section greatly exceeds in its application the purposes for which it was enacted. We believe that benefits are already taxable to employees and to shareholders under sections 5 and 8 respectively, reinforced by sections 137 and 138, so that the only reasonable necessity for section 16(1) would be with respect to other persons for inadequate considerations.

Recommendation: It is recommended that the wording of the section should be changed to confine its application to instances where benefits are bestowed without adequate consideration on persons other than employees and shareholders and for purposes of tax avoidance.

INADEQUATE CONSIDERATION
Section 17(2)

This section covers sales to a person with whom the taxpayer is not dealing at arm's length at a price less than what is determined to be the fair market value. The fair market value must be used by the vendor for the purpose of computing his income and, if such is the case, the purchaser should be entitled to use the same market value for the purpose of computing his income and must have the right to be reassessed. Accordingly this section should be amended by the addition of the following "and the fair market value thereof shall, for the purpose of computing the purchaser's income, be deemed to have been paid or to be payable therefor".

TRANSFERS TO SPOUSE, MINORS, ETC.
Sections 21(1) and 22

These sections provide that where property is transferred from a taxpayer to his spouse or to a minor or trust, the income from the property shall be included in the income of the transferor in later years. It should be made clear that these provisions should apply only to the excess of the value of the property so transferred over the value of the consideration received therefor.

HUSBAND AND WIFE
Section 21(2) and (3)

These provisions disallow the deduction from taxable income of the remuneration paid to a wife who is employed by her husband or a partnership in which her husband is a partner.

Recommendation: It is recommended that the remuneration received by an employed spouse should be deductible and treated as separate income in the employee's hands, where the services are actually performed and a compensation is not greater than what would be paid to another person for the same services.

CHARITABLE DONATIONS
Section 27(1)(a)

The 1957 amendment to this paragraph refers to "the aggregate of gifts made by the taxpayer in the year (*or* in the immediately preceding year, ...)". It is suggested that the underlined words should read "and" instead of "or".

MEDICAL EXPENSES
Section 27(1)(c)

The medical expense allowance is presumably designed to allow taxpayers a deduction for catastrophic or unduly severe medical expenses which have the effect of reducing income and which are uncontrollable. The section as presently written limits the amounts of expenses deductible and also the drugs which may be included and therefore the deduction allowable in many cases falls short of the original intention of the legislators.

Recommendation: It is accordingly proposed that the present restrictions on the amounts allowable be rescinded, and necessary drugs be included.

BUSINESS LOSSES
Section 27(1)(e) and Section 63

Where the income of a trust or estate is payable to the beneficiaries each year, under subsections (4) and (6) of section 63, the income is taxable in the hands of the beneficiaries rather than the trust or estate. Where in these circumstances the trust or estate is carrying on business and wishes to carry back or forward and deduct business losses under section 27(1)(e), it is understood that the Department of National Revenue has taken the position that the loss is not deductible under section 27(1)(e) because under paragraph (iii) of that provision the deduction is limited to the taxpayer's (i.e. the trust's or estate's) income for the year.

Recommendation: It is recommended that the Act be amended to provide that business losses will be deductible from the amount included in the income of the beneficiaries of a trust or estate under section 63(6) if it would have been deductible from the income of the trust or estate if no deduction were made under section 63(4).

ASSOCIATED COMPANIES — ALLOCATION of $25,000 "BASE"
Section 39(3a)

Recommendation: It is suggested that, where companies deemed associated divided a "base" for the 20% income tax on the first $25,000, leeway be given to the group to reallocate that base on the reassessment of one or more of the companies in that group. Time limits for this should be 60 days from the date of mailing the notice of assessment or reassessment of any of the companies in the group.

AVERAGING INCOMES OF FARMERS AND FISHERMEN
Section 42

Under section 42 the income of a farmer or fisherman may be averaged in five-year blocs in accordance with the requirements set out in this section, whence it follows that if a farmer or fisherman dies or retires from

farming or fishing before an averaging bloc is completed there is no right to average his income for the period expired to the date of his death or retirement.

Recommendation: It is accordingly recommended that section 42 be amended to permit the income of a farmer or fisherman to be averaged for a shorter period than five years where the end of that period coincides with his death or retirement.

RULES RE ASSESSMENTS
Section 46(5)

This subsection gives the taxpayer the right to file an amended return for a taxation year within one year from the day when the return for that year was due for filing if he incurs a deductible business loss in the following taxation year. If, however, the taxpayer is delayed in filing the amended return it would appear that he will lose part or all of the loss deduction. It is suggested that this penalty is too severe and the provision should be amended to require an automatic reassessment of the previous year's taxable income.

WITHHOLDING
Section 47 and Part I of the Regulations

Section 47 imposes an obligation on every person making certain types of payments to withhold such amount as may be prescribed and to remit these amounts to the Receiver General on account of the payee's tax for the year under Part I of the Act.

The provisions of Part I of the Regulations, which prescribe the amounts to be withheld, require withholding of tax from all payments of remuneration to employees, whether not such employees are residents of Canada or otherwise liable to Canadian tax. In addition, the amounts required to be withheld from commissions paid to employee salesmen are based on the amounts paid even though the recipient may be required to pay substantial expenses out of the gross commission income. A similar situation exists in the case of payments made to non-residents in respect of services rendered in Canada, otherwise than in the course of regular and continuous employment. This would appear to apply not only in the case of employees but also to independent contractors performing services in Canada for a fee. In all such cases withholding is required on the basis of the gross amount paid for the services without regard to the expenses incurred in earning the revenue.

Recommendation: It is recommended that section 47(1) and/or Part I of the Regulations should be amended to:

(1) Make it clear that withholding of tax is not required in the case of payments to non-residents of amounts which would not be subject to Canadian tax.

(2) Provide that the amount of income from which withholding is required may be reduced by the amount of expenses incurred by the payee in earning that income.

INTEREST ON TAXES
Section 54(6)

Recommendation: It is recommended that section 54(6) be re-enacted with an amendment to provide that interest shall recommence only from 30 days after the day of mailing of the notice of reassessment establishing any additional amount of taxable income instead of 30 days

from the day of mailing of the notice of the "original assessment".

NOTICE OF OBJECTION
Section 58

There are occasions when taxpayers because of circumstances over which, from a practical point of view, they have little or no control, find themselves denied an appeal against an assessment by reason of the requirement that a Notice of Objection must be delivered within sixty days of the date of the assessment.

Recommendation: It is recommended that provision should be made in the Act to permit such taxpayer to make application to the Minister for an extension of time, and if the Minister refuses, then for an application to a Member of the Income Tax Appeal Board to the same effect.

OBJECTIONS TO ASSESSMENTS
Section 58

Recommendation: It is recommended that an automatic extension of time for filing a notice of objection for a taxation year should be granted to the taxpayer in a case where the taxable income of an earlier year is reassessed after 60 days have elapsed from the day of mailing of the notice of assessment where changes made in the earlier year (such as inventory adjustments, changes in the cost of depreciable property, etc.) affect the taxable income of the later year.

Alternatively, the taxpayer should have the right to require a reassessment of subsequent years affected by an assessment of an earlier year.

Some provision should also be made to permit taxpayers to take advantage of the applicable credit for foreign tax when the foreign tax has been increased with respect to a particular year and the Canadian tax for that year has already been assessed and the normal time for objection to that assessment has already elapsed.

DEDUCTION FOR CANADIAN TAX WITHHELD FROM TRUST INCOME
Section 63

Where a Canadian beneficiary receives income from a foreign estate or trust having income from Canadian sources that is subject to the 15% withholding tax in Canada, such income is subject to tax a second time in the return of the Canadian beneficiary with no provision for a tax credit in respect of the Canadian tax withheld at the source.

Recommendation: It is recommended that the tax withheld from his share of such income should be refunded to the Canadian beneficiary, or treated as a payment of his tax under Part I of the Act, and his right to the 20% dividend credit on any Canadian dividends included in his income should be confirmed.

DIVIDEND DEDUCTION TO A BENEFICIARY OF A TRUST OR ESTATE
Section 63(11)

This provision allows a beneficiary of a trust or estate to claim the 20% dividend credit in respect of his share of dividends from taxable Canadian corporations received by the trust or estate. It would appear that this allowance is lost in a case where an estate is a beneficiary of another estate.

Recommendation: It is recommended that this anomaly should be removed.

RIGHTS OR THINGS OF INCOME NATURE OWNED BY DECEASED TAXPAYER

Sections 64(2) and 64(3)

In Western Canada the large majority of farmers calculate their income on a cash basis. As a result, upon death, the value of their grain and livestock inventory is brought into income under section 64(2).

In the case of grain, it is unlikely that it can be sold except in gradual stages over a period of years and at a price which is uncertain.

This situation creates a hardship to the estate in that the income tax must be paid on the present value of the grain in spite of the fact that a cash return may not be received for a number of years.

Recommendation: We recommend that section 64(3) be extended to permit the value of grain sold by an estate as well as by a beneficiary, to be included in income in the year of sale.

PERSONAL CORPORATIONS

Section 67

Section 32(5)(c) defines rental income from real property as "earned income".

Recommendation: It is recommended that section 32 be amended to exclude from surtax rentals received through personal corporations and now treated as "investment income" by virtue of section 67(1).

Recapture of depreciation of personal corporations is taxable in the hands of the shareholders in the year of recapture as section 43(2) does not apply to personal corporations.

Recommendation: It is recommended that section 43(2) be amended to provide that recapture of depreciation of a personal corporation may be taxable in the hands of the shareholders on record at the end of the taxation year of the recapture as provided for by this section and applicable to other corporations or individuals.

SPECIAL CONTRIBUTIONS BY EMPLOYERS TO SUPERANNUATION FUNDS

Section 76

Section 76 provides that where an employer makes a special payment into a pension fund or plan in respect of past services, the payment may be deducted over a period of ten years. The payment can be made either in instalments or can be prepaid. A problem arises in cases where such a special payment is prepaid and then, before the full amount of the payment has been deducted, the assets of the taxpayer are sold and the taxpayer ceases to have income against which the deductions can be claimed.

A taxpayer makes such a special payment on the understanding it will be deductible for corporate tax purposes. The Department of National Revenue favours the early funding of pension plans as a matter of policy. However, at the time such a special payment is made by a taxpayer, it cannot be forecast whether the taxpayer will discontinue business or sell its business within ten years and cease to earn income. In these circumstances it is submitted that the special payment should be deductible in full for corporate tax purposes. In a case where the purchaser of assets continues the pension plan, it is considered that the purchaser should be entitled to deduct the unamortized portion for tax purposes of the special payment because the prepayment will

normally be reflected in the purchase price for the assets. However, if the purchaser is granted the deduction, the vendor should not also be allowed the deduction either for corporate tax purposes or in calculating its undistributed income on hand.

Recommendation: It is accordingly recommended that, where a taxpayer has made a special pension payment in respect of past services and sells all or substantially all the assets of its business at a time when the payment has not been fully deducted and the purchaser continues the pension plan in effect, the vendor and purchaser should be entitled to make an election which will in effect place the purchaser in the same position as the vendor had been with respect to the deduction of the unamortized balance of the special payment. An analogous provision is section 85D relating to accounts receivable and reserves for doubtful accounts.

The amendment should provide that if such an election is made,

(a) the purchaser will be entitled to deduct the portion of the special payment or payments not deducted by the vendor, at the same rate per year as the vendor would otherwise be entitled to deduct such payment or payments; and

(b) the vendor would not be entitled to deduct the unamortized portion of the special payment or payments either in computing its income or, if a corporation, in computing its undistributed income on hand. (See section 82(1)(a)(ii)(C)).

It is also recommended that in a case where the taxpayer discontinues business, without sale, the whole of the then unamortized payments be made deductible from taxable income.

DRILLING COSTS

Section 83(A)

Certain corporations do not, under the present Income Tax Regulations, have the right to deduct the drilling cost of an oil or natural gas well *inside* Canada from the income of that well, while at the same time they may, under section 1204(1), deduct drilling costs of an oil and natural gas well *outside* Canada from the income of that well.

No provision is made in section 83A for the deduction of drilling or exploration costs by individuals who are in receipt of income from an oil or natural gas well inside or outside of Canada or by taxpayers in receipt of income from an oil or gas well outside of Canada. However, in 1954, section 1204 was added to the regulations permitting a taxpayer in receipt of income from oil or natural gas wells outside of Canada to deduct from the income of *each* such well an amount equal to the cost of drilling the well. The deduction does not include exploration or geological and geophysical costs and is limited in each year to the income of the well itself.

A similar deduction is allowed at the same time to *individuals* who received income from oil or gas wells in Canada. Section 1204 is applicable to the 1953 and subsequent taxation years. The deduction, therefore, is allowed to *taxpayers* who are in receipt of oil or natural gas income outside of Canada and to *individuals* who are in receipt of oil or natural gas income in Canada. Taxpayers by definition include corporations where-

as the term *individuals* excludes corporations.

The present position can be summarized with respect to the taxpayers entitled to deduct drilling and exploration expenses as follows:

(1) Qualifying corporations, that is, corporations whose principal business is –
   (a) production, refining or marketing of petroleum, petroleum products or natural gas, or
   (b) exploring or drilling for petroleum or natural gas, or
   (c) mining, exploring for or processing of minerals

   may deduct in computing their income, all their drilling and exploration costs incurred in Canada, and their drilling costs of wells from which they are receiving income outside of Canada.

(2) Associations, partnerships and syndicates formed for the purpose of exploring or drilling for petroleum or natural gas receive a similar allowance.

(3) Individuals may deduct the costs only of drilling a well from the income from that well whether it is located inside or outside of Canada but may not deduct general exploration costs and of course cannot claim the costs of a dry hole since there should be no income to deduct the costs from.

(4) But other corporations which do not qualify for the special deduction for drilling and exploration expenses may deduct the costs of drilling a well from the income of a well that is outside Canada subject to the same restrictions as individuals.

These other corporations are presumably corporations which, while not qualifying as "principal business" corporations under section 83A, have charters broad enough to permit oil and gas exploration and drilling activities. It seems strange that other corporations should be granted the deduction of drilling costs of a well *outside* of Canada and be denied a like deduction from the income of a well *inside* Canada. It may be such restriction was not intended but in any event the Regulations do not provide for such a deduction.

Recommendation: The Regulations should be amended to provide that all corporations may deduct drilling costs of a well *inside* Canada from the income of that well.

REVOCATION OF ELECTION TO BE TAXED ON 1949 SURPLUS

Section 105

Under this section when a corporate taxpayer elects to pay a tax on its 1949 undistributed income, it becomes liable for any additional tax that may be found payable on assessment.

The computation of undistributed income in many cases goes back as far as 1917 and frequently there are unknown or doubtful items, some of which may be quite material. An example might be where substantial additions are made to the undistributed income arising from surpluses transferred from predecessor companies of which the taxpayer may have had no knowledge.

Because of the possibility of material differences arising in the computation of undistributed income due to unknown factors, the difficulty of adequately determining all the facts of particular transactions after a number of years, the existence of differ-

ences of opinion on interpretation of the law, and the possibility of honest errors, a large additional amount of tax may be assessed that the taxpayer is unable or unwilling to pay.

Recommendation: It is, therefore, recommended that the taxpayer be given the right to revoke an election and recover tax already paid under this section where the assessed tax exceeds the estimated tax by more than a prescribed percentage.

TAX-PAID UNDISTRIBUTED INCOME
Section 105(1), (5) and (8)

Where a taxpayer fails to pay any additional tax assessed under section 105(1) within thirty days from the day of mailing the notice of assessment, he is liable to pay the additional tax but can receive no benefit from the payment because subsections (5) and (8) limit the amount on which the tax is deemed to have been paid to 100/15th of the tax paid with the election or within thirty days of the date of mailing the notice of assessment.

In certain cases valid reasons may exist why the additional tax is not paid within the prescribed time.

Recommendation: It is accordingly recommended that with respect to any additional tax actually paid after thirty days from the date of mailing the notice of assessment, the tax-paid undistributed income should be increased by an appropriate amount in respect of any such additional tax so paid.

NON-RESIDENT COMPANIES
Regulation 412(3)

Regulation 412(3) limits the amount of taxable income subject to allocation to prescribed provinces to the taxable income earned in Canada and limits the amount of salaries and wages to be used in this allocation to the total salaries and wages paid to employees of the permanent establishments in Canada. However, there is no corresponding limitation on the amount of gross revenue to be used for the purpose of this allocation. This appears to be an oversight which requires correction in order to avoid hardship to any company affected.

LEASEHOLDERS, PATENTS, FRANCHISES, CONCESSIONS, LICENCES
Regulation 1100(1)(b)

Under regulation 1100(1)(b) the capital cost allowance for leasehold property is computed separately in respect of each property and on a straightline basis, although all of such leasehold property constitutes one class under class 13 of Schedule B. The same is true under regulation 1100(1)(c) of patents, franchises, concessions and licences described in class 14 of Schedule B. Under section 20(1) and regulation 1100(2), however, all of a taxpayer's property of one of the classes described is lumped together for the purpose of recapturing capital cost allowances and claiming a terminal allowance.

Recommendation: It is recommended that a taxpayer have the right to elect that each item of property described in classes 13 and 14 of Schedule B constitute a separate class so that the recapture and terminal provisions, as well as the percentage deduction provisions, *may* apply to each property separately and that, once an election is made, it be binding on the taxpayer and not changeable except with the consent of the Minister.

COURT PROCEDURES IN TAX APPEALS

(a) Reduction of the $400 Security for Costs

In appeals to the Ontario Appeal Court no Security for Costs is required regardless of the amount involved in the Court below. An appeal, too, can be taken to the Supreme Court of Canada by a deposit of merely $50 in any patent, copyright or trade mark matter whatever arising in the Exchequer Court of Canada, and a deposit of $500 in any other appealable case regardless of whether millions are involved or not. The $400 security requirement of the Exchequer Court is out of line and should be reduced. The taxed and other costs in appeals to the Exchequer Court including the costs of stenography now charged to the parties under items 1 and 2, page 129, relating to "Shorthand Writers" are a sufficient protection against frivolous appeals.

Recommendation: Section 98(4) of the Income Tax Act be amended to reduce the requirement of $400 Security for Costs in appeals to the Exchequer Court to $200.

(b) Limitation on Appeals from the Income Tax Appeal Board

Only the Crown can afford to appeal a tax involving under $1,000 to the Exchequer Court. Appeals to the Board may be limited because, if the taxpayer is successful there, the Crown may appeal to the Exchequer Court, where a tax case involving say $200 could cost the taxpayer over $1,000. With special leave (S.C. Act section 84) the Crown could take the taxpayer even to the Supreme Court on a $200 tax matter.

Recommendation: Unless taxes in excess of $1,000 in the taxation year are involved, there be no appeal from the Board to the Exchequer Court except with leave of the Exchequer Court and then only in specified cases such as the following:

(1) The $1,000 total taxes limit would over a period of years as, for instance, where the item is a recurring one, be exceeded; or

(2) The Crown states that a question of law is involved which should be settled by a higher Court. In such cases, the Crown would be obliged to pay the costs of the taxpayer in all subsequent appeals regardless of the outcome. No security for costs would be required of the taxpayer on appeal to the Supreme Court, since the taxpayer cannot be liable for costs if this suggestion is adopted.

(c) Appeal from the Income Tax Appeal Board to the Supreme Court of Canada

At present, in an important case, which will, in all probability be appealed to the Supreme Court, the parties to the appeal must go through the Exchequer Court after the decision of the Income Tax Appeal Board. This may be reasonable in many instances but not helpful in others.

Recommendation: An appeal from the Income Tax Appeal Board direct to the Supreme Court of Canada should be provided for, when,–

(a) the parties consent and over $10,000 in taxes is involved; or

(b) when a Judge of the Supreme Court grants leave.

BY PETER C. BRIANT, M.B.A., C.A.

Current Reading

MAGAZINE ARTICLES

ACCOUNTING

"RECOMMENDATIONS ON ACCOUNTING PRINCIPLES: EVENTS OCCURRING AFTER THE BALANCE SHEET DATE"; issued by The Institute of Chartered Accountants in England and Wales. *The Accountant*, October 19, 1957, pp. 465-466.

After clearly distinguishing between "events which should be dealt with in the accounts" and "events which may need to be disclosed otherwise than in the accounts", this statement concludes with the following recommendation:

> Events which, at the time of preparing annual accounts, are known to have occurred after the balance sheet date, should not normally be taken into account in preparing accounts unless:
>
> (a) They assist in forming an opinion as to the amount properly attributable, in the conditions existing on the balance sheet date, to any item the amount of which was subject to uncertainty on that date; or
>
> (b) They arise from legislation affecting items in the accounts, for example changes in taxation, or are required by law to be shown in the accounts, for example appropriations and proposed appropriations of profit.

The foregoing recommendation concerns the extent to which events occurring after the balance sheet date need to be dealt with in the accounts for the period ended on that date but events which are properly excluded from those accounts may, nevertheless, be of such importance that they need to be disclosed to shareholders through some other medium . . . .

"THE TASK OF MANAGEMENT — PART I" by H. W. Martin, *The Accountants' Journal*, October 1957, pp. 74-79.

This, the first of a two-part article, deals with the organization of a large commercial office. Representing a distillation of principles gleaned from the author's experience, it is recommended to all accountants in industry.

Some excerpts:

People make an office:

. . . the office is a social group. That means that the accountant must have a range of skills quite apart from his techniques as an expert in double-entry jargon. In short, he must resemble the ideal manager — he must be a leader. . . . He must understand and like people despite their foibles; he must be the personnel manager for his own department, with ability to delegate, inspire, train and develop staff; he must be an educator; he must be articulate so he can express himself clearly, both orally and in writing; he must be resolute and practical . . . .

The task of management:

. . . It is for the organization structure as eventually developed that the accounting system must be tailor-made. It is fundamental that the accounting system must fit the business, not the reverse . . . .

Qualifications of the accounting manager:

Our ideal man must have the ability

to manage, in its widest sense; a man who is always searching for improvements; who is open-minded; who is alive to new developments. He must be a man with an objective fact-finding approach; prepared to learn from professional journals and texts . . . He must, of course, be a trained accountant, particularly in cost and management accounting, but he must also have an extensive knowledge of the business and its organization . . . he must have a certain measure of . . . 'divine discontent', so that he is never really satisfied with conditions as they are . . .

Methods and procedures improvement: . . . . it is safe to assume that if a written procedure is more than a year old, it is out of line with current practice, or is not as simple, direct and efficient as it could be . . . ."

AUDITING

"How Can the Auditor Assist Management in Developing Its Use of Operations Research?" by B. C. Kelleher. *The Internal Auditor*, December 1957, pp. 43-51.

Industrial auditors should study some of the literature on operations research so that they may advise management whenever opportunities for applying the technique arise, states the author of this article, a controller of a manufacturing company. Stressing that the auditor should not be expected to undertake the project himself, Mr. Kelleher sees the auditor's role as one which may be conveniently limited to visualizing the problem, determining whether or not operations research will be useful in finding a solution, and deciding what data will be required to assist in the project. "If the auditor's only achievemen is to have stimulated the interest of management in O.R.," writes Kelleher, "he has performed a valuable service . . . "

BUSINESS

"Canada's Model Workmen's Insurance" by Eric Curwain. *The Business Quarterly*, Fall 1957, pp. 291-298.

"Every working day, the Workmen's Compensation Board of Ontario deals with more than 1,100 reported accident cases and at least one fatal accident," reports Eric Curwain, a public relations consultant. "An injured person without compensation," he continues, "would feel he had become one of the 'Have-nots;' . . . . it is therefore a good industrial relations plan . . . ."

If Mr. Curwain's figures for Ontario may be taken as representative of all provinces, Canadians have every reason to be proud of the administration of their compensation Acts in comparison with other countries. Administration costs of workmen's compensation in Ontario, for example, are said to consume 8c of every $1.00 received; the balance of 92c goes to the treatment, rehabilitation and compensation of the injured worker. This is to be compared with the breakdown of costs in the United States where administration is considered to be efficient if claimants receive 50% of the funds collected from employers.

In Canada, workmen's compensation is conducted at cost, whereas a large proportion of the money collected in the U.S. is used up in administration expenses, insurance company profits, and overhead charges. The cost to Canadians would apparently increase if the scheme were to be turned over to private enterprise; the author cites one recent study which indicates that private insurance coverage of an exactly similar nature would, if written, cost five to seven times as much.

MANAGEMENT

"Current Trends in Top-Management Compensation" by Dean H. Rosensteel. *The Management Review*, December 1957, p. 10 et seq.

In a comprehensive survey, covering 35,000 top-ranking executives in over 3,800 companies throughout the United States and Canada, the American Management Association has found that the compensation levels of top management rose again in 1956 and part of 1957. In a year when profits rose by 5%, the average increase in top-management compensation is reported to have amounted to 5.1% – the result of an increase during 1956 of 4.4% in salaries, 8.8% in payments under bonus or incentive plans, and 4.1% in contributions to retirement funds. This is to be contrasted with an overall increase in top-management compensation of 5.9% in 1955, a year in which profits rose by almost 25%. "Clearly then," states the author of this report, "although profits are the most direct measure of top-management performance, the rate of change is not directly reflected in compensation . . . "

"Top Management and Cost Reduction" by E. Lee Talman. *The Management Review*, October 1957, p. 22 et seq.

Cost reduction and competition are not dissimilar in their impact on people: specifically they hurt, in general they are good. Achieving both is largely a matter of developing the proper climate.

In Mr. Talman's experience, the development of an internal climate conducive to successful cost reduction must start with the chief executive officer and continue with the entire line organization. While conceding the staff officers can help in achieving this end, he believes that opportunities for improving profits will never be fully realized until those with final executive authority are willing to pay the price in time and consistent effort.

In Mr. Talman's own organization, Lever Bros. Company, the achievement of a climate which encourages and rewards imaginative thinking and accomplishment has resulted in a 50% reduction in the accounting staff over a five year period. Despite the fact that salaries and machine rentals have risen, overall accounting costs have been reduced by one-third, he says.

One technique used by Lever Bros. can conveniently be employed by any other firm. Overhead, department by department, is reviewed on a staggered basis in advance of the time when the annual budget is finalized. "When plans are being finalized," writes Mr. Talman, "it's no time to give careful and critical attention to overhead costs . . . "

PROFESSIONAL

"A Blueprint for Appraising and Guiding Audit Staff" by William L. Campfield. *The Accounting Review*, October 1957, pp. 625-629.

This paper presents a plan intended to serve as a blueprint for insuring programmed appraisal, analysis, and counseling of both new and old members of an accounting firm. Rating and appraisal of performance are expected by staff members, asserts the author, and it is a process that is always going on even though, at times, supervisors and managers are unaware of the fact.

To introduce a greater degree of objectivity into the process, Mr.

Campfield suggests that three elements should be present:

(a) Performance requirements should be made known to all staff members and officials of the firm, and performance should be appraised in relation to such requirements.

(b) The appraisal system should be actively used to improve the effectiveness of staff members' performance and to strengthen relationships between staff members and supervisors.

(c) Appraisals of performance should be made at stated intervals, with both staff members and supervisors currently informed of performance status.

The author outlines the steps involved in operating an appraisal process, illustrating his remarks with an exhibit of a minimum guide to performance requirements.

This is an area of professional activity that accounting firms can neglect only at their peril, Mr. Campfield warns. At a time when the profession is expressing increasing concern over the shortage of broadly trained men for senior positions in accounting firms, he believes that too many firms have neglected to provide for the systematic development of a staff member. Too often, he writes, firms are made up of groups of specialists.

BOOK REVIEW

Budgeting: Profit-Planning and Control, by Glenn A. Welsch; Prentice Hall, Inc., Englewood Cliffs, N.J., 1957; 510 pages; $7.95.

In view of today's emphasis on accountants being of service to management, this volume should be most welcome at this time. Professor Welsch, of the University of Texas, deals with a basic management tool. Budgeting is perhaps accounting's most positive way of helping management control the operations of business.

This book is designed for a wide audience: management, accountants in industry or practice, and teachers. A typical comprehensive budget program is outlined and illustrated throughout the book. There are also questions and problems after each chapter. Accordingly, this book is suitable as a text for use in the universities.

The technical and managerial aspects of budgets and the principles and procedures of budgeting are featured. The way a budget program can aid management in planning, coordinating and control is emphasized. A complete budget program covering all phases of operations – sales, production, inventory, materials, purchases, direct labour, expenses – is included. Also dealt with are many related subjects such as variable budgets, breakeven analysis and budget reports. The coverage is comprehensive.

The level of the material ranges from elementary procedures to the less obvious. This is done with an understanding of the psychological factors involved and the practical difficulties encountered when dealing with people. There is ample reference to actual cases, articles and authoritative opinions.

If your company does not budget, then you certainly would be well advised to look the book over. If you are just getting a budget program underway, then it could be a real practical help. If your present budget works well, unless it is perfect, you may find some improvements suggested by the discussion material.

G. H. WARD, *C.A.*
Toronto, Ontario

SHORTER NOTES

"A Case Study in the Development of an Integrated Data Processing Application" by J. M. Otterbein. *Cost and Management*, Sept. 1957.

A rapid growth of business combined with a shortage of clerical personnel created administrative problems for the Group Department of an insurance company. Mr. Otterbein relates, in this case study, how these problems are being solved through the installation of an integrated data processing system and outlines the steps taken in defining the problem, gathering the facts, integrating forms and revising procedures, deciding on machines, and gaining staff acceptance of the change.

"Profit-Sharing Plans" by Warren B. Cutting. *The Journal of Accountancy*, December 1957, pp. 39-42.

An analysis of three case histories illustrating how independent accountants were able to solve management problems for clients by a specifically designed cash-profit-sharing incentive plan. In one case the incentive applies to but one individual, in another the incentive applies to a management team of three, and in the final illustration the incentive covers an entire group of company employees.

"Price Level Changes, Inventory Valuations, and Tax Considerations" by A. R. Cerf. *The Accounting Review*, October 1957, pp. 554-565.

This article illustrates the differing tax liabilities which result from various combinations of inventory valuation method, rate of price change, turnover rate and markup rate during a broad range of historically based inflationary and business cycle price movements. The variables are combined in a manner representative of realistic business cycle and inflationary periods. The emphasis is on determining which combinations of variables are likely to yield significant differences in tax liabilities.

"Will the White-Collar Unions Make the Grade?" by G. S. Odiorne. *The Management Review*, November 1957, p. 18 et seq.

An analysis by the manager of the AMA Personnel Division of some of the key factors bearing upon the probable outcome of the current drive in the United States to unionize the white-collar worker in the office, retail store and laboratory. Particular attention is given to the relationship of white-collar workers to both unions and management.

"Valuing a Business" by M. R. Read. *Accountancy*, September 1957, pp. 380-382.

An excellent discussion of the valuation process by capitalizing expected future profits, circumventing the question of the number of years' profits that should be taken for goodwill. Valuing a business, states the author, means answering two questions: "What profits can be expected in the future? What is a fair yield to be expected from money invested in this concern?"

The problems encountered in seeking to answer these two questions are discussed and illustrated.

SELECTED READING

Accounting

"Ascertainment of Profit in Business" by C. I. R. Hutton; *The Accountant*, Oct. 19, 1957; pp. 452-455.

"The Layout and Design of Accounts" by E. J. Neman; *The Accountant*, Aug. 17 & 24, 1957; pp. 186 *et seq.*

Edited by LAWRENCE G. MACPHERSON, F.C.A.

Accounting Research

Director of Research, C.I.C.A.

Auditors always prefer to issue "clean" reports but on occasion qualification of the report either as to the scope of the audit, or as to the opinion expressed, may be necessary. This situation presents the auditor with a most difficult problem to be faced in the wording of his report.

Miss Gertrude Mulcahy has attacked this problem by examining the forms of qualifications or other comments found in the reports of companies included in the survey on which the 1957 edition of "Financial Reporting in Canada" is based.

Qualification of Auditor's Opinion

The auditor's report is the medium through which the auditor communicates his opinion on the financial statements subjected to his examination. He must make sure that his opinion is clearly stated and that nothing he says or leaves unsaid could result in misleading inferences or cause the reader to rely to a greater extent, than is intended, on the association of the auditor's name with the statements. For many years, considerable attention has been given to the importance of the content and wording of the auditor's report in order that it may convey to the readers the precise meaning intended in the circumstances. Standard forms have been developed and recommended by accounting societies in order to avoid unnecessary confusion arising from the variety of language used by auditors to communicate essentially the same thought. Analyses of the auditor's report appearing in published annual reports show that there has been an outstanding trend towards uniformity of wording and clarity of expression. (See "Financial Reporting in Canada", 2nd ed., pp. 105 and 106, and "Accounting Trends and Techniques", 11th ed., pp. 215-222.)

The auditor's report generally comprises two distinct sections: the scope section, presenting the general nature of the work carried out, and the opinion section, setting out the auditor's findings on the financial position based upon his examination. These two sections are clearly distinguished; the former is a statement of facts, whereas the latter is a statement of opinion. While the essence of the report is contained in the opinion section, the scope section is an essential feature in that it indicates the basis upon which the auditor formed his opinion. Intermediate paragraphs for qualifications or explanations are also introduced as special circumstances require.

Types of Opinion

Depending upon his findings during the course of his examination of the accounts and records, the auditor may express either an unqualified or qualified opinion, or he may disclaim an opinion.

Unqualified Opinion

An auditor is justified in expressing an unqualified opinion if he "has

made an examination which included all procedures which he considered necessary in the circumstances, and is of the opinion that the financial statements 'exhibit a true and correct view' of the financial position of the enterprise at a given date and the results of its operations for the period ended on that date."[1] At this point, it should be noted that the expression of an unqualified opinion by the auditor should not be misinterpreted as a guarantee of the accuracy of the financial statements. The management of an enterprise is directly responsible for the financial statements. The auditor may assist and advise management with respect to the form and content of them, but, in the final analysis, they constitute the representations of the company. The auditor's representations are confined to and stated in his report upon the statements. An unqualified expression of opinion should be regarded as assurance that the auditor is satisfied that, to the best of his knowledge, the financial statements, taken as a whole, correctly reflect the overall picture.

Qualified Opinion

If the auditor has concluded that the financial statements, taken as a whole, generally present a fair picture, but has been unable to satisfy himself completely on some important aspect, or thinks that some part of the financial position or operating results is not adequately presented, he should qualify his opinion. In so doing, he must of course indicate the nature of the reservations and exceptions which precluded an unqualified expression of opinion. The criterion for justification of this type of opinion is that the qualifications, limitations or exceptions are not deemed to be so material as to negate the opinion as to the fairness of the statements as a whole.

Denial of Opinion

In circumstances where exceptions are so material or the scope of the examination so limited as to render valueless any expression of opinion on the statements as a whole, the auditor should refrain from expressing an opinion. If he permits his name to be associated with the financial statements, he should state that he is not in a position to express an opinion and clearly indicate his reasons therefor.

Table 54 of "Financial Reporting in Canada", 2nd ed., shows the types of opinion contained in the auditor's report on the financial statements of the 300 Canadian survey companies for the years ended in 1956, 1955, 1954, 1953. Each year, at least 73% of the opinions were unqualified, and 4% - 5% were qualified. In the remaining cases, it was not clear whether the opinion was intended to be qualified or unqualified. These reports were expanded to include additional comments and explanations, but the language employed did not state that the auditor was taking exception or modifying his opinion as to the fairness of the statements.

There were no instances in which the auditor disclaimed an opinion. As pointed out in the commentary to Table 54, "Since this present analysis was restricted to published annual reports, it would be unrealistic to expect that there would have been any instances in which the auditor stated that it was impossible for him to express any opinion concerning the fairness of the statements as a whole. If such were the case, the report would

[1] C.I.C.A. Research Bulletin No. 6

certainly not be released for publication until steps were taken to remedy the deficiencies which prevented the auditor from expressing an opinion."

Reasons for Qualifications

Circumstances leading to a qualification of opinion usually involve either audit procedures or accounting procedures, and can be classified into the following broad categories:

(i) *Limitations in the scope of examination* – omission of certain essential audit procedures resulting from restrictions imposed upon the auditor either by the client or by particular circumstances.

(ii) *Failure on the part of management to follow generally accepted accounting principles* – disagreement on the part of the auditor as to acceptability of the accounting treatment and form of presentation followed by management.

(iii) *Lack of consistency in accounting principles followed in the financial statements in comparison with those previously followed*– changes in basis of accounting treatment not indicated in the financial statements themselves, affecting their comparability with those of prior years.

(iv) *Uncertainties as to position*– contingencies, the net effect of which neither management nor the auditor can determine at the date of the report.

Table 55 of "Financial Reporting in Canada", 2nd ed., sets out the nature of the limitations and exceptions disclosed in the auditor's reports on the financial statements of the 300 Canadian survey companies in which the opinion was specifically qualified. The principal reason for qualification, in each of the four years analyzed, relates to accounting procedures and involves inconsistencies or inadequacies in the procedures followed by management. The most common specific qualification each year concerns the provision for depreciation.

The eleventh edition of "Accounting Trends and Techniques", pages 223 and 225, provides analyses of the reasons for qualification disclosed in the auditor's reports on the financial statements of 600 American industrial companies. It is interesting to note, that, as in the Canadian reports, the vast majority of the qualifications resulted from changes in the application of or deviations from generally accepted principles of accounting.

Presentation of Qualification

Both from the point of view of the information for the users of the financial statements and for the protection of the auditor, it is imperative that qualifications of the auditor's opinion be expressed in such a way as to leave no doubt as to the extent to which the exceptions affect the adequacy of the financial statements or of the work performed by the auditor. Proper presentation of a qualified opinion requires two things: a clear indication that the opinion is limited or modified and full disclosure of the reasons why. The former is usually accomplished by the use of such modifying phrases as "subject to . . ." or "except that . . ." in the opinion paragraph of the report. With respect to the latter, "Codification of Statements on Auditing Procedure" prepared by the Committee on Auditing Procedure of the American Institute of Certified Public Accountants points out that: "Any exception should be expressed clearly and unequivocally as to whether it

affects the scope of the work, a specific item in the financial statements, the company's procedures (as regards either the books or the financial statements) or the consistency of accounting practices where lack of consistency calls for exception. To the extent practicable, the effect of each such exception on the related financial statements should be given."

The exact location of the details of the limitations and exceptions, of course, varies with the particular conditions encountered by the auditor. Where audit procedures are involved, the details are generally included in the scope section of the report. Where accounting procedures are involved, the details are frequently stated in a separate paragraph immediately preceding the opinion section or, if they can be expressed briefly, are included in the opinion paragraph.

The following are examples of the methods of presentation and extent of disclosure used by Canadian accountants in this respect:

"No provision was made in the year ended December 31, 1956 for accruing depreciation in one subsidiary, the normal annual charge for which would amount to approximately $42,000.

....., subject to the matter referred to in the foregoing paragraph, ..."

"The reduction in the 1956 depreciation charge is referred to in a footnote to the statement of profit and loss.

Except for this reduction. ....."

"Included in current liabilities are provisions and reserves which in our opinion are, in the aggregate, approximately $2,250,000 in excess of the actual liabilities.

....., subject to the exception noted in the preceding paragraph, ..."

"The dividends received during the year from the Subsidiary Company included in the Profit and Loss Account of ..... Limited did not exceed the earnings of the Subsidiary Company for the year. The balance of accumulated profits at the credit of the Subsidiary Company's Surplus Account amounting to $67,462 at April 30th, 1956 have not been included in the accounts of ..... Limited.

Subject to the above, ..."

"No direct verification has been made by us on Accounts Receivable or in connection with advances to Lumber and Pulpwood Contractors.

Subject to the above, ..."

"As explained in Note 2 of the Notes to Consolidated Financial Statement, property and equipment purchased for an amount of $5,000,000 and transferred to the United States subsidiary were recorded on the books of the subsidiary as determined by its officers, predicated in part upon appraisals made by the Consolidated Appraisal Company. The auditors of the United States subsidiary reported that they were not in a position to pass upon amounts allocated to property and equipment not covered by such appraisals.

....., subject to the comments in the preceding paragraph, ...

Ambiguous Expression of Opinion

Unfortunately, the opinions expressed in some reports are rather ambiguous. Tables 55(b) and 56 in "Financial Reporting in Canada", 2nd ed., classify these types of reports into two categories:

1. Those which include an expression of opinion modified by the phrase "Subject to the foregoing" or "Subject to above" preceded by more than one explanation or comment without any clear indication of whether all or just a portion thereof was responsible for the qualification.
2. Those which include comments, explanations and information without a definite indication, in the opinion paragraph, whether such expansions, in effect, constitute a qualification of the auditor's opinion.

Reports in the first group fall short in satisfying one of the basic fundamentals of proper presentation of a qualified opinion: full disclosure of the reasons for qualification. Although the auditor provides the means of determining the possible reasons, a reader of the report must make his own decision as to which of the expansions of the report leads to the modification of the auditor's opinion. Few readers are competent to make such an evaluation and, if they do come to some decision, it may be contrary to the auditor's intentions.

Reports in the second group are deficient in that comments drawing attention to special features are left to stand by themselves without any connecting link with the expression of opinion. A reader must make his own decisions as to the extent to which the comments affect the overall adequacy of the financial statements and of the work carried out by the auditor, and as to whether the auditor's opinion is qualified or unqualified. If such comments are included by the auditor in order to indicate a modification of his opinion, they become qualifications and should be stated or referred to as such in the opinion section of the report.

Table 56 of "Financial Reporting in Canada" shows that the vast majority of the comments appearing in this type of report refer to audit procedures. The most common type, in each of the four years analyzed, is a reference to work done by other auditors in connection with subsidiary companies or branches. It is generally agreed that the auditor must assume responsibility for determining the minimum scope of examination required in each engagement in order to form an opinion on the financial statements. Because of the lack of any modifying phrase in the opinion section of the report, a reader would be justified in assuming that the auditor did not consider it necessary to examine the records of the subsidiaries or branch himself. This of course then raises the question as to why such a reference is included in the report. Is it intended merely as an informative disclosure in no way affecting the auditor's acceptance of full responsibility for the financial statements? Or does it mean that the auditor believes the financial statements to be true and correct according to the information he has received, but that he is not prepared to accept the responsibility for the adequacy of information taken from the accounts of the consolidated subsidiaries not audited by him since that responsibility rests with the auditor of the subsidiary in each case?

In some reports, the scope section is expanded by references to limitations in specific audit procedures or by a statement to the effect that the auditor did not make a detailed audit of all transactions. The subsequent unqualified expression of opinion implies that the auditor did not consider the omitted procedures necessary. However, a reference to them immediately arouses suspicion as to the adequacy of the actual examination, and places doubt upon the reliability of the financial statements and the auditor's opinion.

Auditor's reports are sometimes expanded to provide factual explanations or information which the auditor believes should be made known to the reader. Such expansions should not be interpreted as qualifications of opinion. In order to avoid confusion and misunderstanding, the auditor should make every effort to have management include such information and explanations as footnotes to the financial statements. They are in effect representations which should be made by management, not the auditor.

Edited by GEOFFREY H. WARD, C.A.

Practitioners Forum

Staff Manuals

A very good case can be made as to the necessity for office or staff manuals. They can increase the efficiency of a firm's operations, improve the quality of the work, provide a means of controlling the manner in which the work is done, and aid in the establishment of uniform procedures. On the other hand, there are obvious disadvantages. They are very costly to prepare and may cause undesirable rigidity in procedures, and there is a practical difficulty in keeping them up-to-date.

Ample evidence exists to support these views. Most large, well coordinated firms have office manuals. Most small firms do not.

United States

One source of material on office manuals is the CPA Handbook. In Chapter 7, there is a discussion of the extent of the use of manuals, their revision, types of binders, and contents. Included are examples of a stenographic style manual and a staff manual. In addition, examples of review questionnaires, audit procedure outlines, instructions for the preparation of financial statements and instruction data on tax procedures can be found in the Handbook, as well as information on a filing manual.

Replies to a questionnaire sent out by the American Institute indicated that about half the firms had manuals covering general staff regulations and audit procedures, one-third on statement forms, report preparation, stenographic instructions, one-fourth on tax returns and filing, and one-fifth on review instructions.

Charles S. Rockey

The author of "Accountant's Office Manual", Charles S. Rockey, CPA, managing partner of Charles S. Rockey and Co., Philadelphia, is another excellent source of material on manuals. In his book he devotes six pages to comments on the use and purpose of report manuals and a list of their contents. Also included, is a specimen 16-page employees' manual which contains sections headed: introduction to the firm, office code, audit procedures, general instructions and general policies. This specimen is quite brief but would serve as a good starting point. Then there are four pages of detailed instructions for typists.

His firm's office and staff manual, loose-leafed, multilithed, has 335 pages. The office part, 78 pages, is arranged alphabetically by subject, ranging from "absence" to "whereabouts of individuals", and includes such topics as "annual bonus, bulletin boards, desk housekeeping and whereabouts of files, employees termination clearance, foyer table, organization chart, outside activities, personal characteristics and conduct, and telephones".

The staff part, 222 pages, has major sections on field work, audit procedures, reports, system work, taxes and

working papers. Also dealt with are such topics as "natural business year, unnecessary writing, and management services". The third part, 35 pages on punctuation and the use of words, helps improve the standard of report writing.

Obviously, Mr. Rockey's firm must believe a manual is of considerable value, else they would not have spent the time to prepare such a comprehensive one. Mr. Rockey made a limited number of copies of his firm's manual available to other practitioners. We are indebted to him for this unselfish contribution to the accounting profession.

Canadian Views

In order to obtain some factual data on the procedures of Canadian accountants I wrote to several members of the Practitioners Forum panel.

One sole practitioner doubts whether many firms have office manuals and feels that it is not really necessary that he have one. He goes on to say that if he did want one, the cost should not be too heavy as the preparation would be done a bit at a time, and the manual would be typed and run off in the office. He fears that an office manual might provide a too rigid set of instructions, and so tend to remove his staff's necessary originality. On the other hand, he recognizes that for a larger firm an office manual is needed to provide protection for the partners, as they cannot give individual attention to all phases and details of the work, and to help ensure uniformity. He feels that perhaps the larger firms would be willing to let smaller ones have some of their material, which then could be condensed and rewritten for the use of the small firm, thereby providing them with a manual at a minimum of cost.

Another practitioner, a partner in a firm with two small branch offices, advises that they have no office manuals but do have a "Memorandum re Office Routine". This comprises three foolscap pages dealing with "timesheets and expense vouchers"; "audit files and routines". Here they set out the order for filing working papers and describe the audit check marks to be used. They also have a "memo on inter-office routine" covering preparation of billings to clients, branch bank and cash accounts, and accepting new audits. Another memo on policy matters, including participation in community activities, completes their office memoranda.

This practitioner questions whether the preparation and maintenance of a large manual would be worth the cost. He feels that the main advantage would be in setting forth standard auditing procedures covering routine items such as the form of bank reconciliation. Other areas he feels should be covered are the form of financial statements and reports, ethics and relations with clients.

Another practitioner feels that where there are less than ten employees the need for a manual will not be pressing. Accordingly, a short one will probably suffice. When his firm passed 20 employees in size a manual became necessary for efficient functioning. Its preparation was a difficult task because the growth that gave rise to the need for a manual kept the partners so busy they could hardly find time to write one. However, by concentrated effort over a year and by leaving some controversial matters until later, a manual was produced. One of the intangible

benefits was that the need to state policies in writing forced the partners to determine standard practices and uniform procedures. Prior to this clarification of their position, some policies had been left undecided with a lack of uniformity and efficiency in the administration of the firm.

The manual of this firm comprises some 200 pages, is in loose-leaf form, and has four main parts. The first part, general information, includes data on the history of the firm, office and staff policies and employee benefits. The second part, office procedures, deals with such matters as assignments to jobs, library facilities and letter writing. The third part is for the stenographic department. The fourth part, engagement procedures, covers both tax and audit work. Their manual also includes a complete set of standard working papers for a hypothetical company. The responsibility for its preparation and keeping it up-to-date is shared by all the partners and the office manager.

A sole practitioner advises that he has the use of an office manual prepared by one of the larger firms but naturally cannot expect them to keep his copy up-to-date. Of course, it will become obsolete. He feels that there is no doubt about the importance and benefit of an office manual but that the cost of preparation is prohibitive for the small firm.

The extent to which preparation of office manuals presents a practical problem is illustrated by a comment from a practitioner in an efficient and successful firm with eight partners and several offices. He agrees with the advantages of an office manual, yet reports as follows: "We do not presently possess an office manual of any kind. We have talked at several partners' meetings of the desirability of having such a manual in order to standardize both our procedures and our methods of reporting. To date I can only say that our intentions have been good but that our accomplishments have been nil."

Summing Up

The views of another panel member sum up the situation very well. "The national firms and many of the large local firms do have manuals of a type. The smaller multiple office firms and the medium-size local firms should have a fairly comprehensive staff manual as it would undoubtedly pay many times over for the time invested. The smaller firm and the sole practitioner have to think more of alternatives and of a rudimentary manual. However, there is no reason why the sole practitioner, whenever he spends time working out a solution to a recurring problem, whether a technical, policy or administrative one, should not make notes of his solution. These notes could form the beginning of his staff manual."

In the May column, I will mention a few of the different types of manuals and discuss alternative courses of action available to meet the need for manuals.

Fee Survey

The Colorado Society of Certified Public Accountants' Research Bulletin No. 1, August 1957, "Fee Survey" contains the results of a comprehensive statistical analysis of a questionnaire sent to members of their society. Among the interesting facts reported in this bulletin are the following:

A majority of firms plan to raise

fees for existing clients and new clients in 1957.

The firms outside Denver consistently show a higher percentage of chargeable accountants hours than the Denver firms. The larger firms, regardless of location, show the highest percentage, possibly because of the greater feasibility of changing the size of staff in small fractions. The relationship of chargeable hours to total hours was 83.5% for accounting personnel and 60.3% for secretaries. Larger firms usually have a higher billing rate for secretarial hours but the smaller firms have a higher percentage of chargeable secretarial hours.

Gross fees were derived from the following sources: tax work 25%; bookkeeping 21%; no-opinion statements 19%; audits 19%; management advice 10%; other 6%. Tax work yielded the highest billing rates.

The following are the arithmetic mean hourly rates billed: overall $6.48; secretaries $2.98; juniors $4.31; intermediates $5:65; seniors $6.64; supervisors $8.88; principals $9.49.

Good Writing – A Necessity to the Good Audit Report

"To write really good comments in an audit report is a peculiarly difficult and frustrating task; difficult because involved technical matters must be expressed in language understandable by persons without comparable technical training; frustrating because the auditor's major concern is with auditing, not writing.

"This situation is not conducive to confidence in one's writing ability. Yet the accountant, who must always think clearly and has a flair for taking pains, should write superlatively well. Some accountants have made a mental hazard of writing, believing there is some antagonism between it and accounting. If this were true, the great body of our splendid accounting literature would never have been written.

"We all learned early in life the rudiments of grammar – or where to find them. We learned how to spell – or where to look for correct spellings. With these preliminaries, one or two good reference books and an unabridged dictionary, the accountant is as well equipped as he needs to be to write correctly. With practice and love of his task, style and effectiveness may also be his.

"Because, in an audit report, we are writing about our client's innermost financial affairs, what we write should, theoretically, interest him. We cannot hold his interest, however, if we talk all around the subject, load our comments with trite, abstract, and meaningless words, and in general act as if we are bored with the whole thing. And we are not bored really. We have reached a point in our work where we have a great many important things to say and we are bursting to say them, but we are bothered by the mechanics of putting them down on paper.

"To recast a certain number of sentences so that *we* will not be the first word in 30% of them; to find interesting variants for the ubiquitous *this item, this amount consists of the following*, etc.; in short, to make the comments sound as if they had been written out of the warmth of our own thinking, and not from last year's copy, is one of the toughest jobs in report writing" . . . .

—From the *N.Y. Certified Public Accountant.*

BY A. WILLARD HAMILTON, C.A.

Tax Review

Four ITAB Judgments

The "Review" this month has been devoted to brief analyses of four recent judgments of the Income Tax Appeal Board, which decide questions of somewhat general interest.

Farming — Chief Source of Income

The taxpayer, W. R. Grieve, who had operated a fruit farm at Vernon, B.C., for some 50 years, was allowed a deduction of one-half only of the cash farm loss suffered by him in the years 1953 and 1954. He appealed the assessments maintaining that he should have been allowed the full amount of the losses claimed (including the appropriate capital cost allowances) amounting to $6,539 and $4,851 respectively.

In prior years the Minister had consistently recognized the appellant as a farmer and had allowed any losses suffered. For 1953 and 1954 the Minister invoked the provisions of section 13 of the Income Tax Act holding that the taxpayer's chief source of income was not a combination of farming and some other source of income and concluded that he should be limited to a deduction of one-half of his farming loss—exclusive of capital cost allowances—as an offset against his investment income.

Mr. Fisher, member of the Income Tax Appeal Board, recounted the facts relating to the taxpayer's mode of business since June 1907 when he and his father purchased the farm property in Vernon, B.C., and indicated that the losses in the years under review were largely attributable to somewhat depressed conditions in the business and very severe climatic conditions which had been encountered from time to time.

It was noted that the taxpayer had income from the sale of livestock, fruits and vegetables, crops and seed amounting to something in excess of $2,200 in each of the years involved, but that the expenses of operation greatly exceeded such income. Mr. Fisher reviewed the reasoning in the Exchequer Court judgment in the *Robertson* case (where it was found that a "hobby" farmer had not been operating for a sufficient period of time to earn any appreciable amount of income) and, in distinguishing therefrom, decided that it was open to him to determine "that the taxpayer's chief source of income, even for the years in which he suffered a net loss on his farming operations, was nevertheless a combination of farming and 'some other source of income', — in this case, income from inherited capital or as beneficiary of an estate."

There is another point, however, which is of considerable interest in this case. This is the fact that the assessments for the years 1953 and 1954, which were appealed, were in each case re-assessments. No allegation was made by the Minister that he had not considered the provisions of section 13 when the original assessments were issued, and Mr. Fisher

concluded that since the Minister and his officials were fully conversant – or should have been conversant – with all the provisions of the law (including section 13) a determination must have been made, prior to the issuing of the original assessments, to the effect that the taxpayer's chief source of income was a combination of farming and investments. That being the case, it was his opinion that the Minister had no power to reverse or alter this determination when the re-assessments were issued for the years 1953 and 1954. While the original assessments appear to have been "quick" assessments, they were bona fide assessments under the Act and it must be presumed that they were made after consideration "of all relevant provisions of the Act". This follows the judgment of the president of the Exchequer Court of Canada in *Provincial Paper Limited* v. *Minister of National Revenue* (1955).

Minister's Directive

The long established and oft confirmed principle that informal arrangements with the Income Tax Division, including such widely accepted pronouncements as directives from the Deputy Minister of Taxation, have no standing in the application of income tax law is particularly well illustrated in the judgment of the late chairman of the Income Tax Appeal Board, Mr. Fabio Monet, in deciding against the taxpayer in the case of *R. James Speers Corporation Ltd.* under date of November 22, 1957.

The one point at issue between the taxpayer and the Minister of National Revenue arose solely on a difference of interpretation by the parties of the terms of Directive No. 263 pertaining to "basic herds". In its financial statement for 1952, the taxpayer claimed that receipts of $37,552, of a total revenue of $38,803, were of a capital nature as representing the sale of part of its basic herd. The Minister assessed the full amount as being income subject to tax. A similar situation occurred in 1953.

Much evidence was adduced by the appellant in an effort to show that the provisions of Directive No. 263 had been strictly adhered to but this was rather summarily rejected by Mr. Monet as being irrelevant, with the statement, "I do not intend to analyze this evidence and give an opinion as to who is correctly interpreting Directive No. 263 – the appellant or the respondent – *for I find that such a directive issued by the then Deputy Minister of National Revenue for Taxation* has no legal effect whatsoever, and I disregard it entirely." (Italics added)

It was shown from the evidence that except for a few horses, all animals sold by the taxpayer in 1952 and 1953 were progeny of the animals in the basic herd. "That was exactly the purpose of the appellant's business: to breed horses and sell them and, therefore, the profits realized from that business are taxable." Mr. Monet found that no part of the sales made in 1952 and 1953 were on account of capital.

Permanent Establishment

There has been one previous case[1] where the Income Tax Appeal Board found that the taxpayer had not carried on business in the Province of Quebec to the extent necessary to create a "permanent establishment" and so be entitled to an allowance

[1] *Ronson Art Metal Works (Canada) Ltd.*, Sept. 18, 1956

for provincial taxes under the provisions of section 40 of the Income Tax Act. Now, in the case of *Panther Oil & Grease Manufacturing Company of Canada Limited* (Oct. 4, 1957) Mr. R. S. W. Fordham, member of the Income Tax Appeal Board, decided that the appellant has a permanent establishment in the Province of Quebec and consequently is entitled to the appropriate allowance for the portion of the profits deemed to have been earned in the Province of Quebec under section 400 of the Income Tax Regulations.

The company employed a sales force numbering at least 150 in the Province of Quebec in the year 1954. These salesmen were subject to the direction of a district manager, who, in turn, reported to a provincial or divisional manager. The divisional manager, one Charles A. Tessier, maintained, in the City of Hull, a well-equipped office at his residence where he kept on hand a substantial quantity of the company's products, his garage serving as a warehouse. Mr. Tessier drove about 50,000 miles per year and it was largely his administration and experienced direction which accounted for a volume of business of some $500,000 annually. Stationery supplied to Mr. Tessier from the company's plant at Leaside, Ontario, showed his name, position, address and telephone number in prominent type. It is also important to note that each salesman had full authority to decide on the credit rating of any new customer found, and all signed orders forwarded to Leaside by salesmen in the Province of Quebec were, except in a very few and exceptional cases, honoured without question.

In his judgment, Mr. Fordham included the relevant paragraphs from subsection (1) of section 412 of the Income Tax Regulations, including the following:

> (a) "permanent establishment" includes branches, mines, oil wells, farms, timber lands, factories, workshops, warehouses, *offices, agencies,* and *other fixed places of business;*
>
> (b) where a corporation carries on business through an employee or agent who *has general authority to contract for his employer or principal* or *has a stock of merchandise* from which he regularly fills orders which he receives, the said agent or employee shall be deemed to operate a permanent establishment of the corporation.

He went on to state that section 412 does not say that the "office" or "fixed place of business" must be that of the taxpayer itself. All that is required is an office in which the business is done. The evidence showed that such offices were maintained by the divisional manager and by a number of the district managers. Also, substantial quantities of the goods of the company were kept at these locations. In his opinion the fact that such offices were maintained in private residences should not affect the matter. He concluded that the taxpayer had a permanent establishment in the Province of Quebec qualifying under both paragraphs (a) and (b) above-quoted.

Unexplained Misappropriation

The Thayer Lumber Company Limited discovered a shortage of $8,122 in its receipts for 1954 in April or May 1955, when the company's accounts were balanced. The relative amount was deducted in computing its taxable income for the year 1954, and this was disallowed by the Minister of National Revenue on assess-

ment. After the loss was discovered the two principal shareholders, Messrs. Thayer and Elliott, first thought that there must be some explanation of the loss and it was only in December of 1955 that the loss was reported to the insurance company. After investigation the insurance company refused to reimburse the company or to accept any responsibility in the matter as there was no evidence that the vault had been broken into.

At the hearing, Mr. Thayer reported in detail on the procedure followed in handling cash for a period of some 40 years since the business was established by his father in 1912. It would appear that such procedure left something to be desired in the matter of control and supervision, although a relatively few number of people had access to the books and the company's vault. The taxpayer submitted that the money was lost — or never received — in the course of carrying on its business. It was contended that it was a taxpayer's privilege to conduct his business in whatever manner he wished and that he was not under a duty to carry on business so as to produce a profit.

Counsel for the Minister of National Revenue, however, maintained that the sum under consideration did not fall within the provisions of section 12(1)(a) of the Act (an expense laid out for the purpose of gaining income), although he did admit that if it were shown that the money had been taken by an employee the amount might be deductible. Since it was not known exactly what had happened the amount, in his opinion, did not represent a deductible item.

In the judgment, reference is made to the *Imperial Oil* case where the payment for damages and other costs incurred, as a result of a collision of one of the company's vessels with another vessel, was found to have been an expense of carrying on business. It was there held that, in order to deduct an expense, it is unnecessary to show that it earns income.

In the present instance, Mr. Snyder, assistant chairman of the Income Tax Appeal Board, did not consider that the character of the loss incurred was altered by the fact that it was discovered in the spring of 1955 and that the taxpayer took no action until December of that year after the loss was confirmed by the accountant engaged to investigate the shortage. In his view, "the loss was an extraordinary event but, nevertheless, it occurred in the usual routine of business activities". The loss took place because of a long standing practice of the founder, Mr. Thayer, Sr., adopted by his successor, the appellant company, in assuming that all people are honest and "whether the moneys were taken by an employee of the company or by others is unknown but the loss occurred in the usual course of the appellant's operations and is a deductible expense".

BY J. E. SMYTH, F.C.A.

Students Department

Associate Professor, Queen's University

PROBLEM 1

Final Examination, October 1956

Auditing II, Question 6 (16 marks)

A client informs CA that he has an opportunity to purchase a controlling interest in P Co. Ltd. The latest condensed balance sheets of P Co. Ltd. and its wholly-owned subsidiary S Co. Ltd. are as follows:

BALANCE SHEETS

as at December 31, 1955

	P Co. Ltd.	*S Co. Ltd*
ASSETS		
Cash	$ 38,000	$ 10,000
Accounts receivable	253,000	90,000
Inventories, at the lower of cost or market	479,000	155,000
Prepaid expenses	54,500	3,000
Investment in S Co. Ltd. at cost less dividend of $50,000 representing surplus at acquisition received immediately after purchase of shares	122,000	–
Cash surrender value of life insurance	1,000	–
Fixed assets, at cost	1,173,000	461,000
Accumulated depreciation	(577,000)	(275,000)
P. Co. Ltd. – preferred shares	–	2,000
P. Co. Ltd. – advance	–	35,000
	$1,543,500	$ 481,000
LIABILITIES		
Bank loans and overdraft	$ 133,000	$ 10,000
Accounts payable	86,000	48,000
S Co. Ltd. – advance	35,000	–
Income taxes payable	15,000	1,000
Reserve for redemption of preferred stock	13,000	–
Sinking fund bonds 4½% due 1964	180,000	–
Serial bonds 4% due 1956/59	78,000	–
Capital stock	76,800	65,000
Surplus arising from redemption of preferred stock out of earned surplus	148,500	–
Earned surplus	778,200	357,000
	$1,543,500	$ 481,000

The capital stock of the two companies as at December 31, 1955 is made up as follows:

	AUTHORIZED	ISSUED	
	No. of Shares	*No. of Shares*	*Amount*
P. Co. Ltd.			
5% cumulative redeemable preferred shares of a par value of $100 each ..... First preference as to assets and dividends. Without voting power unless six quarterly dividends are in arrears, in which event each share represents five votes	16,000	518	$51,800
"A" common shares of no par value ..... Fixed cumulative preferred dividend of 60 cents. Participates share for share with "B" up to 15 cents after "B" receives 60 cents. Each share represents one vote if dividends are 90 cents in arrears.	20,000	2,000	20,000
"B" common shares of no par value	5,000	500	5,000
S Co. Ltd.			
Common shares of no par value (no change since acquisition by P Co. Ltd.)	10,000	6,500	65,000

In addition to the above information, CA is handed the financial statements of P Co. Ltd. and S Co. Ltd. for the past five years on which a chartered accountant has expressed an unqualified opinion. CA notes that there are no arrears of dividends. The client requests that CA carry out whatever investigation may be necessary to report on the progress of the business.

Required:

(*8 marks*) (a) Calculate the consolidated book value of a 51% controlling interest in P Co. Ltd. as at December 31, 1955.

(*8 marks*) (b) Outline the points which CA should cover in his report.

A SOLUTION

(a) Consolidated Book Value of 51% Controlling Interest in P Co. Ltd. as at December 31, 1955

		Allocation of Equity		
Equity of P Co. Ltd.		*Preferred*	*Class A*	*Class B*
Capital stock	$ 76,800	$51,800	$20,000	$ 5,000
Capital surplus	148,500			148,500
Reserve for redemption of preferred stock	13,000			13,000
Earned surplus	778,200			778,200
	1,016,500			
Excess of book value of S Co. Ltd. over value on books of P Co. Ltd. ($422,000 – $122,000)	300,000			300,000
Total consolidated book value	$1,316,500	$51,800	$20,000	$1,244,700
Controlling interest – 51% of $1,244,700 = ...				$ 634,797

(b) Points which should be covered in report to client

1. If the dividend requirements for the preferred and the "A" common shares are not met, the holders of these shares will assume control of the companies.
2. A schedule of comparative profits for the past five years eliminating inter-company sales and charges and non-recurring profits and losses.
3. A schedule of earnings per share on all classes of stock for each of the five years.
4. Calculation of the return on book value of investment for each of the companies and for the companies combined.
5. Statements of sources and applications of working capital and changes in working capital.
6. A summary of the details of the sinking fund bond agreement.
7. A schedule of the maturity dates and amounts of the serial bonds.
8. Details of the life insurance policy.
9. A schedule presenting the significant financial ratios for each of the five years (e.g., the operating ratio, and the inventory turnover ratio).
10. A statement of the basis of costing inventories.
11. A review of the depreciation policy of the companies.
12. A comparison of the earnings of the companies with those of the industry as a whole, if available.
13. An explanation of the bank loan, including the necessity for it, and the security pledged.
14. Analyses of sales and purchases indicating the extent to which sales are confined to large customers, and the number of material suppliers.

Editor's comments

1. The examiner reports that candidates were not penalized if in their answers to part (a) they assumed that class "A" shares would participate pro rata in surplus with class "B" shares.
2. In the editor's opinion, the following would be an alternative method of arriving at the solution for part (a):

P CO. LTD.
Consolidated Book Value of "B" Common Shares at 31 Dec. 1955

Assets		
Cash	$ 48,000	
Accounts receivable	343,000	
Inventories	634,000	
Prepaid expenses	57,500	
Cash surrender value of life insurance	1,000	
Fixed assets at cost less depreciation	782,000	
		$1,865,500
Liabilities		
Bank loans	143,000	
Accounts payable	134,000	
Income taxes payable	16,000	
Sinking fund bonds	180,000	
Serial bonds	78,000	
		551,000
Total shareholders equity		1,314,500

Deduct equity of preferred shares		
Issued	51,800	
Less held by S Co. Ltd.	2,000	
		49,800
		1,264,700
Deduct equity of class "A" shares		20,000
Equity of class "B" shares		$1,244,700
Controlling interest — 51% of $1,244,700 =		$ 634,797

PROBLEM 2

Final Examination, October 1956

Auditing III, Question 4 (12 marks)

Because of expanding business, J Manufacturing Co. Ltd., built a new factory building in 1950 and installed all new equipment in it. The company also continued to operate its old factory for the period from 1950 to the end of the 1954 fiscal year.

At the beginning of 1955 there was a drastic drop in the company's business and the old factory building was shut down. The management proposes that, in 1955, no provision should be made for depreciation on the old factory building and the machinery in it. They contend that, while the old plant is still useful, it is not in use and is therefore not wearing out, and that if such depreciation were provided, it would increase their costs, overvalue their inventory and place the company in a poor competitive position to bid for business.

Required:

Discuss the proposal made by management.

A SOLUTION

Discussion of proposal that depreciation on old factory building and machinery be not recorded for 1955

1. For accounting purposes depreciation is attributable to a combination of several elements, in particular to obsolescence arising from economic factors, to wear resulting from use, and to deterioration caused by aging through time. Consequently depreciation cannot be said to cease entirely when operations are stopped. Depreciation, particularly on the building, is probably more a function of time than of use.
2. Management is correct in arguing that depreciation increases costs, but costs cannot be reduced by ignoring it. The company has a plant which is subject to depreciation and its method of accounting is designed to recognize such cost. If costs are being incurred it is better to recognize the fact than to report misleading financial results on which future decisions may be based.

3. Depreciation on the old building and machinery need not go through the inventory account and affect the figure for closing inventory. Depreciation on the idle plant and machinery should be excluded from manufacturing factory service if it is a significant amount. It should be set out as a separate charge against operations, and need not be considered in setting prices on a competitive market.
4. The reduction in assets which is continually taking place as a result of depreciation must either be recovered in revenues realized under competitive trading or acknowledged in a direct or indirect reduction in shareholders' equity.

PROBLEM 3

Intermediate Examination, October 1957

Accounting 1, Question 1 (10 marks)

The president of E Co. Ltd., incorporated under the Companies Act (Canada), wishes to know whether the company's financial statements, prepared by the company's accountant, are in accordance with good accounting principles.

He asks CA to comment on each of the following:

(*i*) Improvements to leased premises costing $185,000, of which $95,000 has been amortized, are shown on the balance sheet under the caption "Deferred Charges" and described as:
"Leasehold Improvements, at cost less amounts written off—$90,000".

(*ii*) Reserves for commissions payable and reserve for contingencies are shown on the liability side of the balance sheet under the heading "Reserves".

(*iii*) The description of capital stock on the balance sheet does not mention the number of shares authorized.

(*iv*) 20% of the proceeds of the sale of common shares of no par value has been added to the balance of earned surplus.

(*v*) A stock dividend which was paid during the year has been charged to the account "Excess of appraised value of fixed assets over cost". The balance of this account had been unchanged for seven years.

(*vi*) The financial statements make no reference to a special common cash dividend of material amount which was declared five days after the balance sheet date.

(*vii*) On the statement of profit and loss, no details of sales revenue or cost of goods sold are reported.

(*viii*) Expenditures made on account of future business are charged as a selling expense on the statement of profit and loss.

(*ix*) All amounts shown on the financial statements have been adjusted to the nearest dollar.

(*x*) There is no mention on the financial statements of the fact that E Co. Ltd. has guaranteed a bond issue of its wholly-owned subsidiary company.

Required:

CA's comments as to the presentation and disclosure of each of the above items.

A SOLUTION

Comments as to the presentation and disclosure of items on the financial statements

(i) The presentation of leasehold improvements would be improved by showing their original cost and the amounts written off to date.

(ii) The so-called "Reserve for commissions payable" is a liability (probably a current liability) and it should be shown as such on the balance sheet and described merely as "Commissions payable". This balance should not be designated as a reserve. The Reserve for contingencies is an allocation of earned surplus and should be shown as such in the shareholders' equity section of the balance sheet.

(iii) The description of capital stock on the balance sheet is not complete without a disclosure of the number of shares authorized.

(iv) The 20% allocation of the proceeds of the sale of no par value shares should be segregated from earned surplus and described as "Distributable surplus" with an indication that it represents contributed rather than earned surplus.

(v) The stock dividend should be charged to Earned surplus account rather than to "Excess of appraised value of fixed assets over cost".

(vi) The special common cash dividend of material amount declared five days after the balance sheet date should be disclosed in a footnote or in explanatory comments.

(vii) A complete analysis of the operating results of a business requires a knowledge of its sales revenue and cost of goods sold. It is desirable that these data be shown in most cases.

(viii) Expenditures made on account of future business should not be included in selling expense but should instead be shown as a deferred charge or prepaid expense on the balance sheet.

(ix) The adjustment of all amounts shown on the financial statements to the nearest dollar is good accounting practice.

(x) The parent company's guarantee of a bond issue of its wholly-owned subsidiary is a contingent liability of the parent company and good accounting principles require that it be brought to the attention of shareholders of the parent company.

PROBLEM 4

Final Examination, October 1957

Accounting I, Question 1 (22 marks)

The executor of the estate of J prepared the following information relating to the assets of the estate as at July 1, 1956, the date J died:

(1) Cash in bank and in house	$ 25,000

(*ii*)	B Co. Ltd. 4% bonds, interest payable May 1 and November 1, par value		$150,000
	Cost of bonds at date of purchase	$135,000	
	Market value at date of death and at date of probate	148,500	
(*iii*)	Life insurance issued on J's life:		
	(1) Payable to estate — premiums paid by J		$ 30,000
	(2) Payable to N Co. Ltd.. — premiums paid by N Co. Ltd.		30,000
	(3) Payable to wife — premiums paid by J		20,000
(*iv*)	Automobile — purchased in 1955 at a cost of		$ 6,000
	Estimated market value at date of death and at date of probate	$4,000	
(*v*)	Residential property — purchased in 1948 at a cost of		$ 45,000
	Estimated market value at date of death and at date of probate	$51,000	
	There was a $10,000 5% mortgage on the residence. Interest thereon, payable quarterly, March 1, June 1, September 1 and December 1. Interest due on June 1, 1956 had been paid.		
(*vi*)	Mortgage receivable on local real estate		$ 10,000
	Interest at 6% per annum quarterly on January 31, April 30, July 31 and October 31. Interest due April 30 had not been paid as at date of death.		

The terms of J's will provided for:

(*i*) Bequests as follows:

$3,000 to the deceased's church
1,000 to the Canadian Red Cross
2,000 to housekeeper

(*ii*) J's daughter is to get the car.

(*iii*) The income from the estate is to go to J's wife and on her death the principal is to be divided equally between his daughter and son.

In the last ten years of his life, J had made the following gifts to his family:

(*i*) In April 1951, $10,000 Government of Canada bonds to his wife. The market value thereof was $9,500 at date of transfer, and $9,750 at date of death and at date of probate.

(*ii*) On July 30, 1953, $15,000 Government of Canada bonds to his daughter. The market value thereof was $14,500 at date of transfer, and $14,650 at date of death and at date of probate.

(*iii*) In June 1955, $30,000 in cash to his son on which J paid the gift tax.

The cash transactions reflected in the executor's records for the period July 1 to December 31, 1956, were as follows:

Cash Receipts

July 4	Cash transferred to trustee	$ 25,000
July 30	Proceeds from life insurance policy payable to estate	30,000
Sept. 30	Sale of B Co. Ltd. bonds — full settlement of principal and interest to September 30, 1956	151,000
Nov. 1	Mortgage held on local real estate foreclosed	9,405
Dec. 1	Interest on L Co. Ltd. bonds	3,750
		$219,155

Cash Disbursements

July 15	Funeral expenses	$ 750
July 30	Payment to widow on account	2,000
Aug. 1	Payment of debts existing as at July 1, 1956	3,000
Aug. 15	Legal fees re probate	2,000
Aug. 30	Payment to widow on account	2,000
Sept. 1	Interest on mortgage on residential property for three months ended September 1	125
Sept. 15	Redecorating one room of residence	400
Oct. 1	Purchase of $125,000 L Co. Ltd. 6% bonds at 98 plus accrued interest, interest due June 1 and December 1	125,000
Dec. 1	Principal and interest on mortgage on residential property	1,125
Dec. 1	Payment on account of succession duties and interest thereon of $500	5,500
Dec. 2	Payment of bequests	6,000
		$147,900

Required:

(a) Your calculation of the "Aggregate net value" of J's estate for succession duty purposes.

(b) Executor's charge and discharge statements as to principal and as to income for the 6 months ended December 31, 1956.

A SOLUTION

ESTATE OF J

STATEMENT OF AGGREGATE NET VALUE, JULY 1, 1956

Cash		$ 25,000
B Co. Ltd. bonds at market		148,500
Interest accrued May 1 - July 1, 1956		1,000
Life insurance payable to estate		30,000
Life insurance payable to wife		20,000
Automobile at market		4,000
Real estate at market		51,000
Mortgage receivable		10,000
Accrued mortgage interest February 1 - July 1, 1956		250
Gifts within 3 years of death:		
To daughter $15,000 Dominion of Canada Bonds		14,650
To son — cash (gift tax paid)		30,000
		$334,400
Less: Debts	$ 3,000	
Funeral expenses	750	
Probate fees	2,000	
Mortgage payable	10,000	
Accrued interest payable	42	15,792
Aggregate net value		$318,608

(b)

ESTATE OF J

EXECUTOR'S STATEMENT AS TO PRINCIPAL

July 1, 1956 - December 31, 1956

I charge myself with:		
Assets per inventory — Schedule A, below		$255,750
I credit myself with:		
Funeral expenses	$ 750	
Payment of debts	3,000	
Legal fees	2,000	
Interest on mortgage	42	
Payment of succession duties	5,000	
Payment of bequests	6,000	
Loss on realization of mortgage — Schedule B, below	1,025	17,817
Balance of principal		$237.933
Represented by:		
Cash	$ 73,433	
L. Co. Ltd. bonds	122,500	
Residential property	51,000	
	$246,933	
Less mortgage on property	9,000	
	$237,933	

SCHEDULE A

INVENTORY OF ASSETS

July 1, 1956

Cash	$ 25,000		
B Co. Ltd. bonds	148,500		
Accrued interest	1,000		
Life insurance	30,000		
Residential property	51,000		
Mortgage held on real estate	10,000		
Accrued interest	250		
		$265,750	
Less mortgage on house		10,000	$255,750

SCHEDULE B

LOSS ON REALIZATION

	Inventory Value	*Price Realized*	*Gain (Loss)*
Life insurance policies	$ 30,000	$ 30,000	—
Sale of B Co. Ltd. bonds	148,500	148,500	—
Accrued interest thereon	1,000	1,000	—
Mortgage on real estate	10,000)	9,225	($1,025)
Interest thereon	250)		

ESTATE OF J

EXECUTOR'S STATEMENT AS TO INCOME

July 1, 1956 - December 31, 1956

I charge myself with:			
Interest on B Co. Ltd. bonds	$ 2,500		
Less accrued at date of death	1,000	$ 1,500	
Interest on foreclosed mortgage $\frac{\$200}{\$10,450}$ x $9.405		180	
Interest on L Co. bonds	3,750		
Less accrued at date of purchase	2,500	1,250	
Accrued interest L Co. Ltd. bonds, December 1 - December 31, 1956		625	
			$ 3,555
I credit myself with:			
Payments on account to widow		$ 4,000	
Interest on mortgage on residential property paid	$ 250		
Less accrued at date of death	42	208	
Redecorating room in residence		400	
Interest on succession duties		500	
Accrued interest on mortgage— 1 month — 5% on $9,000		38	
			$ 5,146
Balance owing income (credit)			($1,591)
Represented by:			
Cash overpaid	$ 2,178		
Less accrued interest — $625 — $38	587		
	$ 1,591		

Editor's Comments

1. A considerable number of candidates submitted a statement of cash receipts and disbursements instead of a statement of charge and discharge.
2. The points which gave the most difficulty were the apportionment of the mortgage proceeds, the accruals of interest on bonds and mortgage, calculation of the loss on realization of the mortgage, and determination of the assets making up the balance of principal and income.

NEWS OF OUR MEMBERS

Alberta

Christian, Kergan, Gerla & Berglund, Chartered Accountants, announce the removal of their offices to Rm. 3, Meadwell Bldg., 351 — 13th Ave. S.W., Calgary.

S. Reesor Kaufman, C.A. has been appointed vice-president and general manager of Great Northern Gas Utilities Ltd., Edmonton.

Gordon F. McClary, Robert J. Dunseith and Edmund A. George, Chartered Accountants, announce the merger of their practices. Henceforth the practice of their profession will be carried on under the firm name of McClary, Dunseith & George, Chartered Accountants, with offices at 10019 — 103 St., Edmonton.

British Columbia

S. Tom Fry, C.A. announces the admission to partnership of George A. Rigsby, C.A. Henceforth the practice of their profession will be conducted under the firm name of Fry, Rigsby & Co., Chartered Accountants, with offices at 318 Reid St., P.O. Box 384, Quesnel.

Max Propp, C.A. announces the opening of an office for the practice of his profession at 3346 W. 41 Ave., Vancouver 13.

William H. Clarke, C.A. and Norman J. Down, C.A. announce the formation of a partnership for the practice of their profession under the firm name of Clarke, Down & Co., Chartered Accountants, with offices at Ste. 128, 851 West Hastings St., Vancouver 1.

Manitoba

George Aitken, C.A. has been appointed vice-president and comptroller of The Great-West Life Assurance Co., Winnipeg.

Nova Scotia

McDonald, Currie & Co., Chartered Accountants, announce the opening of an office for the practice of their profession at 206 Roy Bldg., Barrington St., Halifax.

Ontario

Gwendolyn C. Conmee, C.A. announces the removal of her office to The Board of Trade Bldg., 11 Adelaide St. W., Toronto.

Lawford M. Harris, C.A. announces the opening of an office for the practice of his profession at 8th Floor, 145 Yonge St., Toronto 1.

Arthur A. Crawley & Co., Chartered Accountants, announce the removal of their offices to 347 Bay St., Toronto 1.

Ben Greenberg, C.A. announces the opening of an office for the practice of his profession at 237 Compton Ave., Ottawa.

H. I. Holger Dietz, C.A. has been appointed secretary-treasurer of Kerr Steamships Ltd., Montreal.

N. P. Ovenden, C.A. has been appointed comptroller of the Procter & Gamble Co. of Canada Ltd., Toronto.

Campbell, Glendinning & Dever, Chartered Accountants, and Glendinning, Jarrett & Campbell, Chartered Accountants, announce that henceforth their practice will be conducted under the firm name of Glendinning, Campbell, Jarrett & Dever, Chartered Accountants, with offices in Toronto, Montreal, Brantford, Winnipeg, Calgary and Vancouver.

Quebec

McDonald, Currie & Co., Chartered Accountants, and Cooper Brothers & Co., Chartered Accountants, announce that the

firm of Coopers & Lybrand has extended its practice to Germany through the admission of Treuhand-Vereinigung A.G. of Frankfurt Am Main, Berlin, Hamburg, Karlsruhe, Cologne, Munich, Pirmasens, Saarbrücken and Stuttgart.

Hyde & Houghton, Chartered Accountants, Montreal, announce the admission to partnership of D. E. Howley, C.A. and W. G. Low, C.A.

H. B. Savage & Co., Chartered Accountants, announce their association with Legault, Legault & Co., Chartered Accountants, for the practice of their profession, with offices at 610 St. James St. W., Montreal.

Maurice Gold, B.Com., C.A. announces the formation of a partnership with Ronald R. Rush, B.Com., C.A. for the practice of their profession under the firm name of Gold, Rush & Co., Chartered Accountants, with offices at Ste. 41, Bank of Montreal Bldg., 1260 University St., Montreal.

MM. Roger Messier, C.A. et Robert Jacques, C.A. ont formé une nouvelle société qui operera sous le nom de Messier, Jacques & Cie, C.A., Ste. 1, 455 ouest, rue Craig, Montreal.

INSTITUTE NOTES

MANITOBA INSTITUTE

At the annual convocation ceremonies of the Manitoba Institute on January 24, 33 new members were welcomed into the Institute and presented with certificates of membership by J. A. de Lalanne, C.I.C.A. president. At the same time four members of long standing were elected Fellows of the Institute. They are Ward W. McVey, F.C.A., Stanley M. Milne, F.C.A., Edward J. Williams, F.C.A. and J. A. McQuaker, F.C.A., executive secretary of the Manitoba Institute.

QUEBEC INSTITUTE

Second Provincial Conference: The second annual conference of the Quebec Institute will be held at Laval University, Quebec, on Monday and Tuesday, June 16 and 17, 1958. The Faculty of Commerce of Laval. University has kindly offered its facilities for the technical sessions. Residence and meal facilities will also be available at the university.

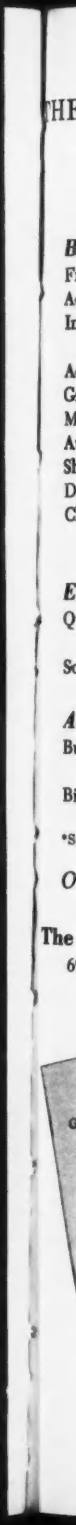
Arrangements for the conference will be handled by the Quebec District Committee of which Albert Garneau is president and Godfrey Gourdeau first vice-president. A Montreal committee under the chairmanship of K. P. Farmer will assist the Quebec committee.

The 78th annual meeting of the Quebec Institute will be included in the conference program.

Members of all Institutes are cordially invited to attend. Quebec Institute members are specially urged to take an active part in the conference, its helpful technical sessions as well as its informal camaraderie, and enjoy the many attractions that make the provincial capital a mecca for visitors.

Convocation: The 1958 convocation of the Quebec Institute will take place at the Ritz Carlton Hotel, Montreal, at 3.00 p.m. on Saturday, March 22. It is anticipated that a large audience will witness the presentation of certificates to new chartered accountants and medals and prizes to winners in the recent examinations, including the C.I.C.A. gold medal for highest standing in Canada to Norman Paul LeBlanc of Montreal.

C.I.C.A. Conference: With the C.I.C.A. conference scheduled for September in



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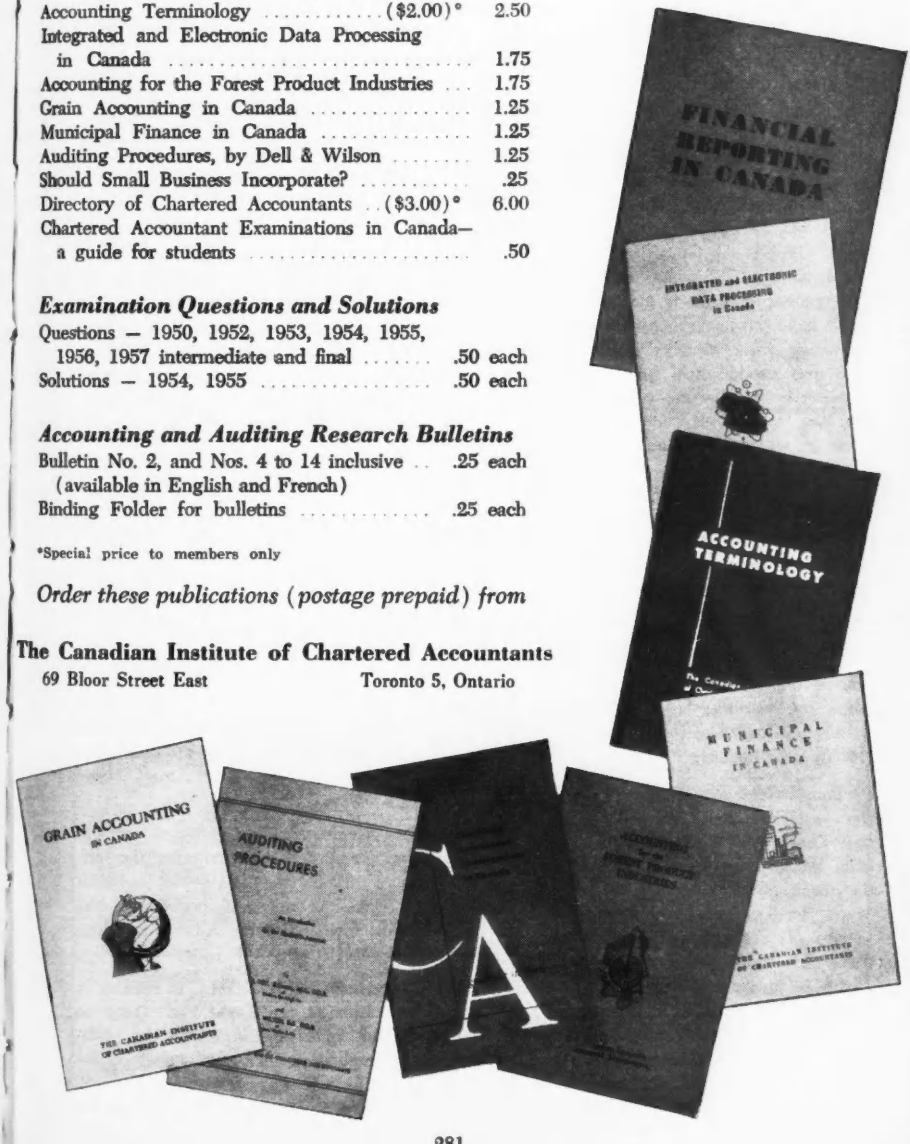


Montreal, already a large committee of Quebec Institute members is at work on plans and arrangements calculated to make this the most successful conference in C.I.C.A. history.

ONTARIO INSTITUTE

Toronto Meeting: The Practising Members Discussion Group Committee of Toronto held a very interesting meeting on January 14. Under the able chairmanship of J. R. M. Wilson, F.C.A., a panel discussed the management consulting services performed by practising C.A.'s. The panel included G. H. Cowperthwaite, C.A., G. Finlay Davis, C.A., H. C. Grant, Ph.D., and B. C. Willis, C.A. The panel, after defining a management consultant and agreeing that C.A.'s have the background for considerable consulting work, decided that other skills were also needed if a full service was to be offered. Small firms can enter the field but they must limit their engagements to those in which they are competent. The panel indicated clearly the difficulties of maintaining a large scale consulting department. High rates of remuneration, excessive travelling, time for research and gaps between engagements all add to the costs. This tends to offset the higher charges received for this work. It was agreed that it was natural for a practising firm to enter consulting work and that the audit staff was in an excellent position to bring the consulting services to the attention of clients needing them. Sixty-five members attended the meeting.

Personnel Selection Tests: The council of the Institute has decided to discontinue the Kuder vocational and personal tests from the testing program. This change is the result of a report on the tests by Dr. Myers, Professor of Psychology at the University of Toronto. His report indicated that while the orientation test was very useful in judging the likelihood of success in the Institute examinations, the Kuder test did not give such indication. The time taken to administer the test will be reduced by half and the charge will be lowered from $10 to $5. Tests may be arranged through the centres in Toronto, Windsor, London, Kitchener and Ottawa.

Personnel Selection, Windsor: The testing centre has now been moved from the home of Dr. L. Wheelton to the home of Mr. W. J. Haydon, 1633 Victoria Avenue, Windsor. Tests can be arranged by getting in touch with Mr. Haydon.

Library: Recent additions are — "Financial Aspects of Health Insurance" by M. G. Taylor; Canadian Tax Foundation, 1957; pp. 102. "Forestry Tenures & Taxes in Canada" by A. M. Moore; Canadian Tax Foundation, 1957; pp. 315. "Guide to Instalment Computations" by M. R. Neifeld; Mack Publishing Co., 1953; pp. 413. "Studies in the History of Accounting" by A. C. Littleton and B. S. Yamey; Richard D. Irwin Inc., 1956; pp. 392. Taxation Statistics, 1957" by Department of National Revenue; Queen's Printer, 1957; pp. 130. "Theory of Inventory Management" by T. M. Whitin; Princeton University Press, 1957; pp. 347.

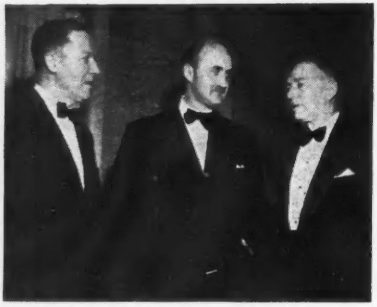
Aids to Automation: The Toronto Chapter of the Systems and Procedures Association has kindly invited all members to attend a one-day exhibit at the Royal York Hotel, Toronto, on March 20, 1958. The exhibitors will be firms selling equipment or services which help to promote office automation. In the evening Harry S. Brown of R. L. Crain Limited will be the speaker at the dinner of the Association. Dinner tickets at $4.50 each may be ordered from V. A. Brown, Office Specialty Manufacturing Co. Ltd., 240 Prospect Street, Newmarket, Ontario.

Assistant Registrar: The president of the Institute is pleased to announce the appointment on February 1, 1958 of V. Ralph Wood, C.A., as assistant registrar. Mr. Wood is a member of the Alberta and Ontario Institutes.

Pre-Computer Clinic: NOMA is holding a two-day clinic at the Royal York Hotel in Toronto on April 21 and 22 on the problems of evaluating the advantages of installing an electronic computer. Institute members are invited and should register

with the National Office Management Association, Willow Grove, Pennsylvania. The fee for non NOMA members is $75.

B.C. INSTITUTE



A. D. Peter Stanley, president of the B.C. Institute, and Hon. Robert W. Bonner, Attorney-General of British Columbia, chat with C.I.C.A. president James A. de Lalanne at the convocation of the B.C. Institute on January 18.

Vancouver Club Formed: More than 200 chartered accountants attended the inaugural luncheon of the Chartered Accountants Club of Vancouver on February 10, 1958 in the ballroom of the Hotel Georgia. The following members were elected to the first executive: Ernest Burnett, John Carter, Gilbert Gary, Floyd Harding, Richard Schulli, Roy Shand and James Sutherland. Honoured guests at the luncheon were Prof. E. D. MacPhee, dean of the faculty of commerce and business administration, University of British Columbia; George E. Winter, senior member of the B.C. Institute; and A. D. Peter Stanley, president of the B.C. Institute.

Prince George Association: At the January 1958 meeting of the Prince George Chartered Accountants Association, C. A. Rampton was elected president, and M. M. Thibaudeau, secretary-treasurer for the 1958 year.

ONTARIO STUDENTS

On January 23, 1958, Paul S. Deacon, investment editor of *The Financial Post*, addressed the Ontario Students Association on "The Stock Market". In an absorbing talk Mr. Deacon outlined the why's of the market's movements in 1957 and gave 1958 predictions. The 90 students present expressed a continued desire for special topic meetings. Adult refreshments and a social period followed the meeting.

VANCOUVER ISLAND C.A. CLUB

The successful Victoria candidates in the final chartered accountant examinations were introduced to the club at a meeting on January 24. This was followed by a discussion on the possibility of assisting students to prepare for their examinations. A committee, composed of Hugh Bardon, Henry Watson and Dennis Roberts, was formed to make definite arrangements for pre-examination lectures or discussion sessions to be held in late August or September 1958.

The speaker of the evening was Dr. Clifford Carl, Director of the Provincial Museum.

Following the meeting, a technical session was held. Mr. C. E. Wesson, director of the local district tax office, outlined his organization and explained some of the operations of the Taxation Division. It is planned to have further technical sessions in the future.

OTTAWA C.A. CLUB

The luncheon meeting of the club held on January 16, 1958, was addressed by W. Bowker, Director of Information, Federal District Commission, who spoke on the national capital plan, illustrating his talk with slides. Prizes were presented by the club to the three successful candidates in the recent C.A. final examinations with the highest marks in the Ottawa area. They are: N. G. Ross, T. W. I. Kirkconnell and L. J. Rentner.

WESTERN ONTARIO C.A. CLUB

The C.A. Club of Western Ontario held its annual at home on Friday, February 28 at the Hotel London. The evening featured a smorgasbord followed by dancing to George Tingey and his orchestra.

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